The Co-operative Bank Holdings Limited and The Co-operative Bank plc Annual Report and Accounts 2017

Preface

The Restructuring and Recapitalisation of The Co-operative Bank plc (Bank Company) created a new incorporated holding company, The Co-operative Bank Holdings Limited (Holding Company), which owns 100% of the Bank Company shares. 5% of the Holding Company A shares were issued on incorporation and the then existing shareholders exchanged their Bank Company shareholdings for a further 5% of the fully-diluted issued A Shares of the Holding Company.

The remaining A shares of the Holding Company were issued as part of:

i. a debt for equity swap (17.4%), involving all Subordinated Tier 2 Notes held by Subordinated Noteholders (other than the 2023 Notes held by Retail Noteholders which were subject to a Mandatory Cancellation by way of Retail Cash Consideration paid by the Bank Company to the Retail Noteholders);
ii. the Backstop agreement (5.0%); and
iii. the subscription of £250m cash in consideration for A Shares in the Holding Company (67.6%).

The proceeds of the above, together with the release of the Subordinated Notes, were used by the Holding Company to subscribe for further shares in the Bank Company as part of the Restructuring and Recapitalisation as well as extinguishing the Subordinated Notes. Further details of the transactions are disclosed in note 2 to the consolidated financial statements.

The Holding Company's share capital is divided into Class A ordinary shares of £0.0001 each and Class B redeemable preference shares of £0.01 each. The A shares are entitled to dividends to be paid out of the profits of the Holding Company, but the B shares do not carry any right to participate in the profits of the Holding Company, except as provided for on a Bank Exit (any transaction or arrangement which results in the Holding Company ceasing to be the Bank's direct or indirect Holding Company or ceasing to hold directly or indirectly substantially all of the assets of the Bank) or IPO Exit (admission of the A shares of the Holding Company to a securities exchange, as defined in the Articles of Association of the Holding Company (Holding Company Articles)). On a return of capital on liquidation, dissolution or winding up, the surplus assets of the Holding Company are applied as follows, in respect of each B share, first an amount equal to the nominal value (and if such proceeds are insufficient, allocated between them pro rata to the aggregate amount due to each), and second, the balance remaining (if any) shall be distributed to the A shareholders pro rata by reference to the number of A shares held by them respectively.

No A shareholder is entitled to receive notice of, nor attend to vote at a general meeting of the Holding Company, save where a resolution is to be proposed at such meeting: abrogating or varying any of the rights or privileges attaching to the A shares; for the winding up or dissolution of the Holding Company; in respect of the purchase or redemption (save for the redemption of B shares) of any share capital of the Holding Company; or in respect of a Bank Exit or IPO Exit. Each and every B shareholder is entitled to receive notice of, attend and vote at a general meeting of the Holding Company, with one vote in respect of each B share registered in the name of the holder, in accordance with the Holding Company's Articles of Association.

The consolidated financial statements for the year ending 31 December 2017 comprise the Holding Company and its controlled entities (the Group), the Bank Company and its controlled entities (the Bank), as well as entity only results for the Holding Company and Bank Company. As the Group is considered to be a continuation of the Bank, (see note 1 to the consolidated financial statements) the comparative figures presented in the Group consolidated financial statements are those of the Bank for the year ended 31 December 2016.

As the Holding Company has no trading operations of its own, the consolidated financial statements, governance and risk management for the Group are substantially the same as those for the Bank. The 2017 Annual Report and Accounts have been prepared on a basis that covers both Group and Bank reporting requirements, written mainly from the perspective of the Group, but highlighting explicitly where the Bank differs.

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The glossary for this document can be found at http://www.co-operativebank.co.uk/investorrelations/financialresults

KEY PERFORMANCE INDICATORS

The Key Performance Indicators presented below reflect the way in which the performance of the consolidated Co-operative Bank Holdings Limited (Group) and the consolidated Co-operative Bank plc (the Bank) were measured in 2017. The comparative figures provided for 2016 are those of the Bank.

Returns KPIs

	Definition	Why it is important to the business and management	
Group statutory profit/(loss) before tax	This represents total profit/(loss) once all income and expenses are taken into account except tax, at the Group consolidated level.	This is a primary profitability measure used by management to assess performance.	**2017: £216.0m** 2016: (£477.1m)
Group adjusted loss before tax	This represents the Group's loss excluding the £356.3m income statement gain generated as a result of the Restructuring and Recapitalisation.	This is a primary profitability measure used by management to assess performance.	**2017: (£140.3m)** 2016: (£477.1m)
Bank statutory loss before tax	This represents total loss once all income and expenses are taken into account except tax, at the Bank consolidated level.	This is a primary profitability measure used by management to assess performance.	**2017: (£174.4m)** 2016: (£477.1m)
Net interest margin	The difference between interest received from loans/other assets and interest paid out on deposits/other liabilities. Net interest margin is calculated as net interest income divided by the average of the opening and closing asset balances for the period.	The net interest margin is the key measure of the ability to generate revenue.	**2017: 1.22%** 2016: 1.40%
Cost:income ratio	The proportion of revenue which is used to fund operating costs calculated by dividing operating costs plus operational projects expenditure by operating income excluding losses on asset sales.	A principal measure of the efficiency of overall operations.	**2017: 108.1%** 2016: 103.6%

Capital and liquidity KPIs

Capital and liquidity is measured at the Group level. Capital requirements are part of the regulatory framework governing how banks and depository institutions are measured.

	Definition	Why it is important for the business and management	
CET1 Ratio	Common Equity Tier 1 (CET1) is equivalent to tangible shareholders' funds less certain capital deductions. Calculated as CET1 resources expressed as a percentage of Risk Weighted Assets (RWAs).	There is a requirement to maintain minimum regulatory capital and capital ratios at all times. As there are currently only CET1 resources, the minimum Pillar 1 capital requirements i.e. 8% of RWAs are met entirely with CET1 resources.	**2017: 24.7%** 2016: 11.0%
Total Capital Ratio	The ratio of total capital resources to total RWAs.	There is a requirement to maintain minimum regulatory capital and capital ratios at all times. The total capital ratio is important in order to withstand any future market-wide or individual stresses.	**2017: 24.7%** 2016: 17.7%
Leverage Ratio	A ratio calculated by dividing Total Tier 1 capital (after deductions) by adjusted balance sheet exposure.	Under the UK leverage ratio framework, a minimum leverage ratio requirement applies to firms with retail deposits greater than or equal to £50bn. Whilst this minimum leverage ratio requirement doesn't currently apply, the leverage ratio continues to be assessed against the broader UK requirement.	**2017: 4.9%** 2016: 2.6%
Total Risk Weighted Assets (RWAs)	RWAs are required to be calculated to provide for three types of risk: i) Credit risk, ii) Market risk (included in credit risk); and iii) Operational risk.	Capital ratios are a measure of risk calculated from the sum of the three RWA categories.	**2017: £5.1bn** 2016: £6.7bn
Liquidity Coverage Ratio (LCR)	LCR is the primary regulatory standard for liquidity and Individual Liquidity Guidance is set with reference to LCR. UK banks are required to maintain a minimum of 90% of LCR, rising to 100% in 2018.	Represents a surplus to regulatory requirements. A strong liquidity position aligns to the risk strategy to maintain a prudent liquidity position, although the surplus to regulatory requirements may vary due to cash flow mismatches and fluctuations in the funding profile over time.	**2017: 213.0%** 2016: 213.5%

Franchise KPIs

The KPIs below are measured at Group level but are applicable to the Bank.

	Definition	Why it is important to the business and management	
Customer assets	The outstanding amount of money lent to customers.	The interest received on loans is the primary source of revenue. The amount and quality of assets is considered against risk appetite and their capital requirements.	**2017: £16.7bn** 2016: £19.4bn
Mortgage completions	The value of new mortgage applications completed within the year.	Mortgages are the primary type of lending and new business needs to be continually written to replace mortgages that redeem. This is a key objective of the Financial Plan.	**2017: £3.2bn** 2016: £3.1bn
Mortgage redemptions	The value of the mortgages that have been redeemed during the year.	Minimising redemptions in order to generate net asset growth is included within the Financial Plan.	**2017: £2.7bn** 2016: £1.7bn
Customer deposits	The amount of money customers hold in their accounts, also known as customer liabilities.	Customer deposits are a key source of funding to support customer assets. To manage the overall interest expense, these deposits are optimised versus other sources of liquidity.	**2017: £20.6bn** 2016: £22.4bn
Total current account holders	The total number of open current accounts.	Current accounts are a key product.	**2017: 1.4m** 2016: 1.4m
Prime current account holders	Customers holding an account with who on average pay in £800 or more per month.	A measure of the size and quality of active current account customer base.	**2017: 648k** 2016: 664k
Net Promoter Score (NPS)	A measure showing how likely a customer is to recommend The Co-operative Bank as a current account provider.	NPS is a good indicator of business and growth as it is a measure of customer advocacy/loyalty and an indication of the level of customer service being delivered.	**2017: 20** 2016: 17

HR Key performance indicators

The KPIs below are measured at the Bank level but are applicable to the Group.

	Definition	Why it is important to the business and management	
Colleague engagement	Engagement level for employees is measured based on responses to questions covering five areas. This is a measure of colleague sentiment based on their advocacy, confidence, commitment, pride and their willingness to give discretionary effort that supports productivity and performance.	Our people are vital to our success. Given the challenges the Bank has faced, it is essential that colleagues continue to feel engaged and committed. Engagement has increased by 11 points in 2017 to 75% (compared to 64% in 2016) which will help to deliver the 2018-2022 Financial Plan (the Plan).	**2017: 75%** **2016: 64%**

Gender diversity[3,4]

YE 2017	Female No.	Female %	Male No.	Male %
Board[1]	1	11%	8	89%
Executive Management Team[2]	2	29%	5	71%
Other employees	2,302	60%	1,546	40%
Grand total	2,305	60%	1,559	40%

YE 2016	Female No.	Female %	Male No.	Male %
Board[1]	2	17%	10	83%
Executive Management Team[2]	3	33%	6	67%
Other employees	2,517	59%	1,728	41%
Grand total	2,522	59%	1,744	41%

1. Board: Includes Executive and Non-Executive Directors.
2. Executive Management Team: Includes senior managers who have responsibility for planning, directing or controlling the activities of the business.
3. The table above is based on head count as at December 2016 and 2017.
4. For further information about gender diversity, see page 33.

GROUP PERFORMANCE - KEY HIGHLIGHTS AND OUTLOOK

Building a sustainable franchise

- Successful completion of the Restructuring and Recapitalisation in September 2017 generating an additional £712.5m of CET1 (before costs), including £250m of new CET1 issuance.

- A £336.8m reduction in 2017 adjusted loss before tax and both a strong regulatory capital and liquidity position, reporting a 24.7% CET1 ratio and 213.0% Liquidity Coverage Ratio (LCR).

Financial performance

- Group profit before tax of £216.0m including £356.3m impact of the Restructuring and Recapitalisation. Excluding this impact the adjusted loss before tax is £140.3m, an improvement of £336.8m compared to 2016 loss before tax of £477.1m.

- Bank loss before tax of £174.4m differs from the Group due to the accounting treatment of the extinguishment of the Tier 2 notes as they are treated as a capital contribution and recorded in equity rather than the income statement.

- Reduction in full year adjusted loss is supported by continued reductions in operating expenditure, reflecting lower staff costs (£35.1m) and non-staff costs (£20.6m). An increase in the Cost:income ratio to 108.1% reflects reduced income due to the challenges discussed below.

- Total project expenditure reduced from £309.5m in 2016 to £88.3m driven primarily by the conclusion of a number of projects during 2016 and 2017.

- A £129.8m reduction in fair value unwinds following maturity of Leek Finance Number 17 plc and Leek Finance Number 18 plc in 2016 and Leek Finance Number 19 plc in June 2017, the Optimum securitisation and the write-off of the remaining Britannia merger fair value. These are now complete.

- A £22.8m gain relating to the sale of shares in VocaLink.

- A £38.9m gain after tax (£51.9m gain before tax) as a result of an agreement with the Britannia Pension Scheme (BPS) Trustee to change the index used to determine increases for pensions in payment from the Scheme which are linked to inflation, from RPI to CPI.

- A £2.5m increase in conduct risk charges totalling to £27.4m in 2017 primarily reflecting an additional provision of £38.5m recognised in respect of historical PPI selling. Significant progress has been made elsewhere across the Redress and Remediation programme.

- Net interest income reduced in 2017 by £77.2m to £317.6m which contributed to a 0.18% reduction in net interest margin to 1.22%, due to reduced margins on liabilities following the base rate reduction in 2016, sales of gilts and residential mortgage backed securities (RMBS) held in Treasury and EIR asset adjustments driven by increased experience of customers redeeming their mortgages rather than remaining on SVR.

- Reduction in non-interest income of £12.3m due to increased Everyday Rewards expense as more customers opt in to receive benefits, a reduction in packaged account income as volumes decrease, lower fee income from Business and Commercial Banking (BaCB) liabilities as balances reduce and the non-recurrence of some one-off items in 2016.

- Increase in loss on sale (£12.5m) following the sale of £1.8bn of Optimum assets and deleverage of Legacy portfolio assets.

Trading performance

- A level of uncertainty was anticipated across H1 2017 and into H2 2017 during the Restructuring and Recapitalisation and resulted in some liability attrition to which the Bank responded with pricing actions. The performance improved across H2 2017 in a number of key areas highlighted below.

- Mortgage completions increased year on year by £0.1bn to £3.2bn. Completions across H2 2017 were £0.5bn higher than H1 2017 as the Group began to utilise the liquidity generated from the securitisation of £1.8bn of Optimum assets.

- Largely flat net mortgage lending between 2016 and 2017 although £0.2bn positive net lending across H2 2017 was supported by increased new business completions. This was achieved despite increased redemptions due to both the maturity of existing mortgages and the impact of continued low rates facilitated by the availability of the Term Funding Scheme (TFS) in the market.

- Anticipated and controlled Retail liability outflows in H2 2017, supported by a reduction in the cost of acquiring deposits in Q4 2017 in order to manage the liquidity following resources generated from the Optimum assets securitisation.

- Stable current account balances at £4.2bn with only a small net reduction in accounts demonstrating a strong and loyal customer base. Prime current account volumes relatively flat in H2 at a time of intense switching competition.

- Current account NPS score maintained in top 3 evidencing that continued strong levels of customer service and outcomes have been delivered across 2017 despite a challenging year.

Delivering on our commitments

- Save for net interest margin (NIM), the financial guidance set out at the time of the Restructuring and Recapitalisation has been met.

- Full Individual Capital Guidance (ICG) and combined buffer compliance has been delivered in 2017, a year ahead of target. Significant progress has been made against areas of Capital Requirements Regulation (CRR) non-compliance during 2017 and also an implementation agreement in respect of the Pace Pension sectionalisation has been signed, resulting in the PRA removing the model risk and reducing the pension risk components of the Group's Pillar 2a capital requirement in December 2017.

- Migration of core banking systems to IBM in February 2017 delivered greater resilience through stronger end-to-end disaster recovery capability.

- Successful delivery of £1.8bn whole structure securitisation of the Optimum mortgage portfolio, further de-risking the balance sheet.

- Continued progress on de-risking the pension schemes with Pace sectionalisation on track for completion in 2018.

Values and Ethics at the heart of our business

- Strategic partnership with youth homelessness charity Centrepoint raised over £450,000 from various colleague and customer initiatives including a current account switching incentive and a £25 donation for every mortgage completion from April to December 2017.

- At the same time, customer donations through our Everyday Rewards current account product totalled almost £175,000 for our five charity partners.

- Continued support of The Hive, which provided advice to over 355 start-up co-operative businesses in the UK in 2017.

- In 2017 we marked 25 years of our customer-led Ethical Policy.

Key focus for 2018 and beyond

- Careful redeployment of liquidity surplus across 2018, including continued strong mortgage origination, to support an improvement in the net interest margin.

- Continued focus on delivering cost reduction and assessing other strategic initiatives.

- Completion of key de-risking measures, including Pace sectionalisation and achieving full CRR compliance subject to PRA approval.

Strategic Report

CHAIRMAN'S STATEMENT

2017 was an important year for The Co-operative Bank. In February we launched a sale process alongside considering alternative options to build capital, resulting in a Restructuring and Recapitalisation that concluded on 1 September 2017. This delivered a significant improvement in the key CET1 ratio and total capital ratio to 24.7%. It has also provided the basis to progress to fully meet individual capital guidance (ICG) compliance in December 2017.

Over the past four years the Bank has faced extensive challenges, a number of which were a result of legacy issues and the consequences of the merger with Britannia Building Society (Britannia) in 2009. We have made significant progress in tackling these and have delivered major change, establishing stronger governance, embedding robust risk management, creating a better IT infrastructure and substantially mitigating legacy conduct issues. We have reshaped our business to focus on Retail and SME customers, investing in our digital offering, and in our ethical brand, while continuing to provide the service that is highly valued by our customers.

In 2017 we built on this progress, achieving further key milestones in de-risking the Bank. We securitised a further £1.8bn of assets within the Optimum portfolio which reduced the portfolio to less than 10% of the size it was in 2013, generating significant liquidity to support our future plans. Key uncertainties such as the extent of our pension obligations have been the focus of significant effort to de-risk the Bank's position. Our continued progress in risk management and delivery on commitments within the Plan have resulted in our capital requirements being reduced earlier than anticipated, which has in turn facilitated full ICG compliance.

We have delivered on our commitments to our investors to remove key operational and regulatory constraints, and have reassessed and renewed our plans to realise our long term strategy. As we move forward, our reinforced capital base grants us a platform to return to profitability and ensure a viable and sustainable future. This will require further relentless focus on simplification and cost reduction; systematic improvements to our offering and nurturing our differentiated ethical brand. We will prioritise our successful mortgage and savings businesses and at the same time continue to build on the valued service we provide to small business, co-operative and charity customers.

I would like to pay tribute to the extraordinary commitment of Board Directors in this critical year. In September, Maureen Laurie and Alistair Asher stepped down as Non-Executive Directors. In February 2018 subject to regulatory approval, Derek Weir, Chair of the Risk Committee, was additionally appointed Senior Independent Director, replacing Aidan Birkett who is stepping down from the Board after almost three years. Bill Thomas, who joined the Board in 28 October 2013, has taken on the role of Chair of the Remuneration Committee. I would like to express my thanks to them and to all my fellow Directors for their support during my four years on the Board. As previously announced, I will be stepping down on 14 March 2018, and I wish the new Chairman, Bob Dench, every success as he moves into the role.

Our investors, many of whom have been with us since 2013, share our determination to deliver a profitable and successful bank that offers customers a different, ethical choice, and I would like to thank them for their continued support. I would also like to thank the Executive team and all colleagues for their immense contribution over the past four years, which has enabled us to rebuild to the point we have reached today. In particular, the dedication and commitment of our front-line colleagues, which continued to be recognised in numerous industry awards and surveys over the past year, has been absolutely vital - thank you.

Dennis Holt
Chairman
13 March 2018

OUR BUSINESS AREAS

Throughout 2017, the Group was managed and reported on the following basis.

Segment	What they are	Managed Assets	Managed Liabilities	Credit RWAs	Operating Income
Retail Banking	Trades as The Co-operative Bank, Britannia and smile, together with the Group's intermediary mortgage brand, Platform, and includes Retail secured and unsecured lending as well as personal current account and savings products.	**2017: £14.7bn** 2016: £14.8bn	**2017: £18.4bn** 2016: £19.4bn	**2017: £1.9bn** 2016: £1.9bn	**2017: £319.1m** 2016: £372.8m
BaCB	Focused on offering simple solutions to meet the needs of small business (SME) customers mainly focused around savings and current accounts. We continue to service our existing complex customers with a range of corporate banking facilities but seek customers who have: • turnover of less than £25m, • borrowing requirements of less than £5m; or • otherwise meet risk appetite. However we are seeking customers in the Charity and Co-operative sectors.	**2017: £0.3bn** 2016: £0.4bn	**2017: £2.1bn** 2016: £2.7bn	**2017: £0.4bn** 2016: £0.5bn	**2017: £55.0m** 2016: £63.3m
Optimum	A closed book of predominantly interest-only, intermediary and acquired mortgage book assets.	**2017: £0.6bn** 2016: £2.6bn[1]	-	**2017: £0.3bn** 2016: £0.9bn	**2017: (£31.7m)** 2016: (£15.7m)
Legacy Portfolio	Includes: • Corporates – which typically have a turnover of over £25m or otherwise do not meet risk appetite • Commercial Real Estate • Project Finance • Housing Associations • Local Authorities; and • Large scale Renewable Energy and Asset Finance	**2017: £1.1bn** 2016: £1.5bn	**2017: £0.1bn** 2016: £0.1bn	**2017: £0.9bn** 2016: £1.1bn	**2017: (£9.0m)** 2016: (£6.7m)
Treasury	Manages the liquidity, wholesale funding and capital market transactions.	**2017: £7.3bn** 2016: £7.6bn	**2017: £2.1bn** 2016: £3.6bn	**2017: £0.5bn** 2016: £1.0bn	**2017: £11.5m** 2016: £19.6m
Other	Balance sheet and income statement items that are not directly related or managed within any of the operating segments above.	**2017: £0.5bn** 2016: £0.4bn[1]	**2017: £0.3bn** 2016: £0.7bn[1]	**2017: £0.4bn** 2016: £0.5bn	**2017: £1.1m** 2016: £14.7m

1. 2016 balances have been re-presented, for details of the re-presentation please see the Detailed Financial Review on page 20.

Segmentation is under review with the aim of simplifying and reducing the number of segments, and this will be finalised over 2018.

Group Vision

To become an efficient and financially sustainable UK Retail and SME Bank that is distinguished by its values and ethics.

Overarching Strategy

Offer a differentiated proposition, serving a loyal customer base. Serve Retail and Small and Medium Enterprise (SME) customers with products and services differentiated through values and ethics, brand and customer service excellence.	**Offer a choice of distribution channels.** Offer distribution channels and services aligned to customer demand.	**Offer a customer-centric product range.** Offer simple, clear, fair and transparent products to meet customer needs.	**Deliver a right sized operating cost base.** Focus on reducing costs and simplifying our business.

Key goals

- Focus on product profitability, return on equity and return to sustainable profitability
- Maintain our commitment to our Ethical Policy and to co-operative values
- Reduce costs, simplify business processes and improve the cost:income ratio
- Ensure long term regulatory and capital compliance
- Develop and deliver select change initiatives that offer incremental value above and/or de-risk the achievement of the Financial Plan
- Continue to strengthen the Risk Management Framework and our culture
- Energise and empower all colleagues to perform at their best
- Develop our people and capabilities

The table below summarises the strategic activities performed and the associated impact across the balance sheet, income statement and risk.

Business activity	Balance sheet impact	Income statement impact	Principal risks
We lend money to customers.	Originate loans and create assets on our balance sheet that will generate future income.	We earn interest income, fees and may incur credit impairment charges.	Credit risk Market risk Operational risk Liquidity and funding risk Conduct risk
We collect deposits from customers.	Deposits are a source of funding (liabilities) which is often paid for.	We may pay interest on deposits.	Liquidity and funding risk Market risk Operational risk Conduct risk
We source funding from other banks and the capital markets.	Wholesale funding is a liability that is paid for.	We pay interest on wholesale funding.	Liquidity and funding risk Market risk Operational risk
We provide transactional banking facilities.	Minimal.	We earn net fee and commission revenue.	Operational risk Conduct risk
We invest in people in order to implement our strategy and deliver service to our customers.	Minimal.	Staff costs.	Operational risk Conduct risk People risk Pension risk
We invest in our operations (IT and infrastructure) to deliver service to our customers while managing costs.	Property, plant and equipment, Intangible assets.	Non-staff costs and Project Expenditure.	Operational risk Strategic risk

CHIEF EXECUTIVE'S REVIEW 2017

Building a sustainable Co-operative Bank

We concluded 2017 demonstrating a resilient business performance in our priority markets of mortgages and savings, with a stable customer base, despite the uncertainties earlier in the year. The completion of the Restructuring and Recapitalisation on 1 September 2017 led to an increase in CET1 ratio to 24.7%. As the Chairman has indicated, this provides a solid platform to deliver our future plans, while carefully considering incremental opportunities to deliver further value. It is also a factor that has facilitated our Individual Capital Guidance (ICG) compliance, which we have now achieved a year ahead of plan. We are grateful to our investors for their continued support.

While our capital position is now robust, there are many challenges ahead as we work to continue to reduce our losses and build a sustainable profitable Co-operative Bank – our foremost priority as we move forward. Our focus will be on developing our mortgage, savings and small to medium size (SME) banking businesses. As is the case with other Retail banks, we are operating in a difficult marketplace and we expect increasing competition in the mortgage market, which will put pressure on our NIM. Our access to the Bank of England's Term Funding Scheme (TFS) ahead of its closure and recent securitisation of the Optimum book means we have a strong funding position; however we must focus on using that in the most effective way to support future NIM growth. We have made progress in cost reduction but there is more to do and we must continue our disciplined approach in order to achieve our goals.

Resilient business performance

I would like to thank our customers for their support and loyalty during 2017. Mortgage completions, the main driver of our balance sheet, increased compared with 2016 at £3.2bn. We experienced an increase in mortgage redemptions to £2.7bn, which reflects both the maturity profile of our existing book and increased incentives in the market for customers to redeem and switch their mortgages at the end of their fixed rate terms, and which in turn has adversely affected NIM. At the same time we have seen continued low interest rates and strong price competition facilitated by the availability of TFS to competitors. Until recently it was not economically viable for the Bank to access this scheme; however, this changed and in early 2018 we made use of this facility to support further growth in our mortgage business. Although net lending was stable across 2017 as a whole, during the second half of the year our new business growth was stronger and we were able to increase net lending by £0.2bn as we deployed surplus liquidity and made improvements to our product switching service. We expect sustained price competition throughout 2018 and we will be focusing on the broker advised market to enable us to continue supporting homebuyers and homeowners to secure new mortgages and ensure our momentum in the mortgage market continues.

Overall, customers remained loyal over the course of the year and we have continued to enjoy strong levels of customer advocacy with a current account net promoter score of +20 at the end of the year, placing the Bank third in the market. Retail current account balances remained stable at £4.2bn while the number of current account holders fell by 3% over the year. Following the completion of the Restructuring and Recapitalisation in September, we renewed our brand advertising with a campaign marking the 25th anniversary of our customer-led Ethical Policy and the number of prime current accounts remained broadly flat in the second half, despite intense switching competition in the market during this period.

Retail liabilities reduced by £1.0bn in 2017, to £18.4bn at the end of the year, as a result of some fixed-term deposit customers choosing to re-invest their funds with other providers as their savings reached maturity, in light of the uncertainty during the Restructuring and Recapitalisation process. While we proactively priced to retain a proportion of maturing fixed term balances during the Restructuring and Recapitalisation, once that completed we were able to reduce the cost of attracting and retaining savings balances as part of our strategy to deploy excess liquidity, in the final three months of the year. Retail savings remains an important market for us in 2018 and in the future.

Our business banking arm, which specialises in serving SME customers including credit unions, charities, co-operatives and non-profit organisations, proved resilient. During 2017 we were recognised by Moneyfacts with 5 star ratings across the core business current account range, and additionally won Best Service for a Business Bank and Best Charity Banking Proposition at the Moneyfacts Awards. As we look to the future, our specialist SME banking proposition will remain a key component of our strategy.

Although the Group recorded an adjusted loss before tax of £140.3m for 2017, this represents a reduction of £336.8m compared to 2016 and an important step towards achieving sustainable profitability. The key improvements compared to 2016 are lower project expenditure, lower fair value unwinds and reduced operating expenses. The reduction in operating expenses was offset by a reduction in income.

Overall, the Group's NIM for 2017 was 1.22%, 18bps lower than in 2016, primarily driven by reduced income on hedging of non-interest bearing balances following the 2016 base rate reduction, sales of gilts and residential mortgage backed securities held in Treasury, and EIR adjustments driven by customers remaining on Standard Variable Rate (SVR) mortgages for a shorter period than expected. Looking ahead, the continued intense competition in the mortgage market, which has impacted both new business mortgage margins and SVR attrition, will require our continued focus to ensure our NIM remains robust.

An additional provision of £38.5m has been recognised in respect of PPI claims, reflecting increased complaint volumes ahead of the FCA imposed timebar of August 2019, the impact of marketing campaigns and the requirement to mail all previously rejected Plevin complaints. While this is a projection based on recent complaint experience, there remains a risk that a further increase in complaints could emerge as we approach the 2019 deadline.

Delivering on our commitments

With the exception of NIM, the Group has achieved all the 2017 targets in the financial guidance it set out at the time of the Restructuring and Recapitalisation. In particular, we have been able to achieve full Individual Capital Guidance (ICG) and combined buffer compliance in 2017, a year ahead of target. This has been facilitated by the completion of the Restructuring and Recapitalisation, the hard work of our colleagues embedding a robust Risk Management Framework and strong governance, and the agreement to sectionalise the Pace pension scheme agreed as part of the Restructuring and Recapitalisation. Since then we have signed the Implementation Agreement relating to Pace sectionalisation, a further important step in that process. These factors have in turn enabled us to achieve a reduction in our capital requirement.

The Group has also begun to deliver on the strategic commitments it set out to investors during 2017. In October the Group completed a significant £1.8bn whole structure securitisation of part of the Optimum mortgage portfolio, the impact of which can be seen in the 2017 results. Along with other movements, total Optimum risk weighted assets are £0.6bn lower compared to 2016.

We have continued to develop our digital offering, encouraging increasing numbers of customers to carry out transactions online, and we have seen a reduction in branch and telephone banking transactions. As a result, we have announced further reductions to our branch network, to reflect the changing way that customers are choosing to bank with us. Our branch network remains an important element of our multi-channel approach, and we have also invested in branches in areas with high footfall. In October 2017 our branch network was voted top UK bank branch network for customer service by GFK achieving a score of 76%. From June 2018 we will have a network of 68 branches.

A further major milestone in building greater resilience was achieved with the migration of our mainframe-based core banking systems to IBM in February 2017. This has delivered stronger end-to-end disaster recovery capability and ensured that we met key regulatory requirements relating to the remediation of the IT estate. This has enabled us to meet regulatory threshold conditions and has reduced the Group's overall risk profile.

Values and Ethics at the heart of our business

Our ethical brand remains central to our business and in 2017 we marked 25 years of our customer-led Ethical Policy, which is still the only one of its kind among UK banks, with a strategic partnership with youth homelessness charity Centrepoint as they established a base in Manchester for the first time. The partnership has included two customer initiatives – a current account switching incentive and a £25 donation for every mortgage completion from April to December 2017, in addition to colleague fundraising activity, including over 100 colleagues taking part in Sleep Out events in Manchester and London. Through this activity we have raised over £450,000 for Centrepoint during 2017. At the same time, customer donations through our Everyday Rewards current account product totalled almost £175,000 towards five other charity partners.

We continue to support our local community in Manchester and the North West. I was proud of our colleagues and customers' support of the community response to the tragic events in Manchester in May, fundraising towards the British Red Cross UK Solidarity Fund, and collecting donations through our branches and customer contact centres. In August, we were a sponsor of Manchester Pride for the second consecutive year.

Our support for the wider Co-operative movement continued with our sponsorship of co-operatives' business support service The Hive, which in 2017 provided advice and promoted co-operative working to over 355 start-up co-operative businesses across the UK. We also supported Co-operatives UK in their emergency response to hurricanes in the Caribbean and Philippines.

People and culture

I would like to thank all colleagues for their resilience and their remarkable commitment during 2017. We ended the year with employee engagement scores reaching their highest levels since 2014, which provides an excellent foundation as we continue work to achieve our aim of a sustainable and profitable Group.

The Co-operative Bank was one of the first companies to sign up to HM Treasury's Women in Finance Charter in 2016, and in 2017 we made progress towards our Charter Commitments, which we have set out in a five point plan which will over time help us address our Gender Pay Gap, details of which we published in November 2017. We continue to improve the working environment for colleagues and, in the fourth quarter, we completed the move to our newly refurbished head office in the heart of Manchester city centre, which will also enable us to achieve planned cost savings from 2018.

Summary

Following a period of uncertainty around the future of the Bank, I would like to express my thanks to our customers for their loyalty and to our colleagues, investors and wider stakeholders for the support they have shown. As our Chairman, Dennis Holt, prepares to step down, I would like to thank him for his important stewardship and in particular for the support he has shown to me and my Executive colleagues during 2017. I look forward to working with Bob Dench as he is appointed Chairman this month.

As we look to the future, our key objective will be to achieve a sustainable, profitable bank that provides an ethical banking proposition for our customers. Whilst there are many challenges to delivering this given the legacy issues we have faced, and the difficult market conditions in which we operate, I am confident that we can build further on the progress we have made in 2017 and I look forward to continuing to create a successful Co-operative Bank.

Liam Coleman
Chief Executive Officer
13 March 2018

DETAILED FINANCIAL REVIEW

The numbers presented in this section are on a management accounting basis. Segmental net interest income is presented post the application of the funds transfer pricing. A reconciliation of the management basis to the statutory Group income statement can be seen in note 3 to the consolidated financial statements.

All numbers are presented on a Group basis. These are equivalent for the Bank unless otherwise stated. All comparative figures are those of the Bank.

Explanation of material matters that impact the income statement

1) Impact of the Restructuring and Recapitalisation

The Restructuring and Recapitalisation generated £712.5m of CET1 (before costs), including £250.0m from the issuance of new Common Equity Tier 1 (CET1) capital, £64.4m from CET1 issued to the non-Retail Tier 2 holders and a £397.8m income statement gain on the extinguishment of the Tier 2 debt within the Group. This income statement gain of £397.8m is presented in other exceptional items in the summary income statement below.

Total costs relating to the Restructuring and Recapitalisation were £63.3m, of which £41.5m has been recognised in other exceptional items in the income statement and £21.8m has been recognised directly in equity.

The net income statement impact of the Restructuring and Recapitalisation is £356.3m.

The impact of the Retail debt extinguishment and transaction costs on net assets is consistent between Group and Bank and has been recorded partly through the income statement and partly through equity as described above, in accordance with International Financial Reporting Standards (IFRS) and the Companies Act 2006. The difference between the fair value of the shares issued and the carrying amount of the bonds extinguished has been recognised directly in equity (via share premium as discussed in note 33 to the consolidated financial statements), as the loss is borne by the debt holder who is also the shareholder (i.e. the Holding Company) and so constitutes a capital contribution.

The Bank loss before tax differs from the Group due to the accounting treatment of the extinguishment of the Tier 2 notes. In Bank, this is treated as a capital contribution and recorded in equity, see note 2.1 to the consolidated financial statements for additional information.

2) Impact of further Optimum deleverage

In October 2017, £1.8bn of Optimum assets were securitised as part of Warwick Finance Residential Mortgages Number Three plc (Warwick Finance Three), whilst retaining 5% (approximately £90m) of the notes and residual interest across all classes. The transaction generated an overall loss before tax of £7.8m included within the income statement below, a £0.9bn reduction in Risk Weighted Assets (RWAs) and a £6.4m reduction in the Expected Loss shortfall.

Income statement impacts

£m	Loss on disposal	Release of allowance for loss	Release of merger fair value	Transaction costs	Total
Loss on asset sales	(16.5)	-	-	(4.3)	**(20.8)**
Operating income	(16.5)	-	-	(4.3)	**(20.8)**
Impairment gains on loans and advances	-	3.0	-	-	**3.0**
Operating result	(16.5)	3.0	-	(4.3)	**(17.8)**
Fair value unwinds	-	-	10.0	-	**10.0**
Group profit/(loss) before taxation	(16.5)	3.0	10.0	(4.3)	**(7.8)**

Optimum balance sheet impacts

	December 2016	Warwick Finance Three Impact	Other Movements[1]	December 2017
Gross loans and advances	2,618.3	(1,836.5)	(188.1)	**593.7**
Provision for losses	(12.5)	3.0	1.5	**(8.0)**
Accounting adjustments	17.1	(10.0)	(7.2)	**(0.1)**
Gross customer balances net of provision for losses	2,622.9	(1,843.5)	(193.8)	**585.6**

1. Includes book repayments and the write-off of the remaining Britannia merger in 2017 (£3.3m).

3) BPS Pension revaluation

During the year the Group agreed with the Britannia Pension Scheme (BPS) Trustee to change the index used to determine inflationary increases for pensions in payment from the Scheme, from RPI to CPI. This change is considered to represent a plan amendment and has given rise to a £51.9m one-off gain in other exceptional items in the income statement in 2017.

Summary income statement

	2017	Re-presented 2016[3]	Change
	£m	£m	£m
Net interest income	**317.6**	394.8	(77.2)
Loss on asset sales	**(26.5)**	(14.0)	(12.5)
Non-interest income	**54.9**	67.2	(12.3)
Operating income	**346.0**	448.0	(102.0)
Impairment gains/(losses) on loans and advances	**1.1**	(2.3)	3.4
Income net of impairment	**347.1**	445.7	(98.6)
Operating expenditure – staff	**(152.6)**	(187.7)	35.1
Operating expenditure – non-staff	**(236.5)**	(257.1)	20.6
Operational project expenditure	**(13.6)**	(33.9)	20.3
Operating result	**(55.6)**	(33.0)	(22.6)
Conduct risk	**(27.4)**	(24.9)	(2.5)
Remediation project expenditure	**(50.9)**	(141.3)	90.4
Strategic project expenditure	**(23.8)**	(134.3)	110.5
Severance	**(7.0)**	(21.5)	14.5
Other exceptional items	**431.0**	58.1	372.9
Share of post-tax profits from joint ventures	**0.4**	0.3	0.1
Fair value unwinds	**(50.7)**	(180.5)	129.8
Group profit/(loss) before taxation	**216.0**	(477.1)	693.1
Net interest margin[1]	**1.22%**	**1.40%**	(0.18%)
Cost:income ratio[2]	**108.1%**	**103.6%**	(4.5%)

Group profit/(loss) before taxation	**216.0**	(477.1)	693.1
Impact of Restructuring and Recapitalisation	**(356.3)**	-	(356.3)
Group adjusted loss before taxation	**(140.3)**	(477.1)	336.8

Group profit/(loss) before taxation	**216.0**	(477.1)	693.1
Group consolidation adjustment	**(390.4)**	-	(390.4)
Bank profit/(loss) before taxation	**(174.4)**	(477.1)	302.7

1. Net interest margin is calculated as net interest income divided by the average of the opening and closing asset balances for the period.
2. Cost:income ratio is calculated as operating expenditure and operating projects (including associated depreciation and amortisation) divided by operating income excluding losses on asset sales.
3. Re-presentation detailed on page 20.

The Group generated a profit before tax of £216.0m in 2017. Excluding the impact of the Restructuring and Recapitalisation (£356.3m) the Group recorded an adjusted loss before taxation of £140.3m. This compares to a loss before taxation of £477.1m in 2016, which is an improvement of £336.8m.

The Bank loss before tax of £174.4m, differs from the Group due to the accounting treatment of the Tier 2 notes. In Bank, this is treated as a capital contribution and recorded in equity, as described in note 2.1 to the consolidated financial statements.

Net interest income

Net interest income (NII) reduced by £77.2m to £317.6m (2016: £394.8m).

Retail NII has reduced by £44.8m to £300.0m (2016: £344.8m) following:

- overall Effective Interest Rate (EIR) asset charges of £19.7m in 2017, compared to a £5.0m credit in 2016. This reflects a reduction in the anticipated future income generated from customers on Standard Variable Rate (SVR) mortgages, with customers expected to remain on revisionary products for a shorter period of time than previously assumed;
- a reduction in average mortgage margin as higher rate back book balances redeem and are replaced with lower rate new business and retentions;
- a reduction in higher margin unsecured balances year on year;
- a reduction in the hedging yields generated on current accounts; and
- a reduction in customer deposit margins, following the base rate reduction in August 2016 in addition to a reduction in the average customer deposit balances year on year (post the application of transfer pricing customer deposit balances generate a positive net interest in the Retail portfolio).

BaCB NII has reduced by £13.2m to £37.4m (2016: £50.6m). This is driven by:

- lower average customer deposits in 2017 compared to the prior year following deposit outflows experienced in early 2017 (post the application of transfer pricing customer deposit balances generate a positive net interest income for the BaCB portfolio);
- lower yields generated on hedging of current account balances; and
- lower net interest income generated on assets across 2017 following an overall attrition in the asset book and the transfer of a portfolio of Renewable Energy and Asset Finance (REAF) and Project Finance Initiatives (PFI) assets back to Legacy portfolio. The interest income generated on these assets was recorded within BaCB for the majority of the prior year.

Legacy net interest expense has increased by £2.3m to £(3.4m) (2016: £(1.1m)) due to:

- lower arrangement fees unwinding through interest income in 2017 following the prior year deleverage, which resulted in a greater level of unamortised fees being accelerated into 2016.

Optimum net interest expense has reduced by £6.1m to £(10.7m) (2016: £(16.8m)) following:

- a reduction in interest expense on both the Leek Note funding vehicles following their maturities during 2016 and 2017, and coupons paid on the Calico Credit Default Swap following a regulatory call in September 2017; partially offset by,
- the execution of Warwick Finance Three and the loss of income generated on the mortgages that were securitised.

Treasury net interest expense was £(7.3m) in 2017 compared to net interest income of £8.5m in 2016, a reduction of £15.8m following:

- the Bank of England base rate reduction in August 2016 resulting in reduced income generated on the hedging of the Group's non-interest bearing balances;
- the sale of assets, yielding spreads higher than are available in the current market, such as trading gilts and residential mortgage backed securities (RMBS) and increased wholesale repo volumes, have further contributed to reduced income; partially offset by,
- lower interest expense following the maturity of RMBS and EMTN and the redemption of the £456.0m of Tier 2 notes as part of the Restructuring and Recapitalisation.

Other NII has reduced by £7.2m to £1.6m (2016: £8.8m). 2016 included a number of non-recurring prior year subsidiary accounting adjustments.

Net interest margin

The Net interest margin (NIM) for 2017 YTD reduced by 18bps to 122bps (2016:140bps).

Customer assets contributed a 4bps improvement, driven by:

- volume increases in the intermediary mortgage lender Platform (+16bps) offset by lower Direct mortgage balances (-6bps);
- lower blended margin (excluding EIR) in Direct and Platform portfolios (-3bps) following back book redemptions, continued price competition facilitated by the availability of the Bank of England's Term Funding Scheme to competitors, which until recently has not been economically viable for the Group to access, resulting in lower new business margins and a greater incentive for customers to redeem and switch their mortgages;
- improvement in Optimum assets margin (+1bps) following a lower interest expense on external notes (Calico Credit Default Swap and Leek Special Purpose Vehicles (SPVs)) offset by the lower interest income following the completion of Warwick Finance Three; and
- balance reductions across the combined Legacy and BaCB portfolios (-4bps), following deleverage activity and overall asset run-off respectively.

Customer liabilities contributed a 3bps reduction, driven by;

- lower yields generated on Retail and BaCB current accounts hedging following the lower average yield curves in the year (-5bps);
- lower balances and adverse mix within the Retail savings portfolio (-1bps); and
- higher average current account balances (+3bps).

Treasury/wholesale funding contributed a 6bps reduction as a result of the lower yield generated from assets as outlined above, partially offset by the lower interest expense of the redeemed Tier 2 notes.

Other net interest income including EIR asset adjustments drove a 13bps reduction, primarily following a £24.7m increase in net charges to the EIR asset and a reduction in other net interest income as outlined above.

Loss on asset sales

Loss on asset sales increased by £12.5m to £26.5m (2016: £14.0m). The loss on sale, including transaction costs recorded for the assets securitised in Warwick Finance Three was £20.8m (before provision and fair value releases totalling £13.0m). Legacy portfolio loss on sale was £8.3m lower at £5.7m (2016: £14.0m) following a planned decrease in the volume of asset deleverage year on year.

Non-interest income
Non-interest income reduced by £12.3m year on year to £54.9m (2016: £67.2m).

Retail non-interest income reduced by £8.9m to £19.1m (2016: £28.0m) following:

- an increase in the amount of Everyday Rewards paid to customers as more opted to receive rewards;
- a reduction in packaged bank account income as volumes decreased; and,
- the cost of third party insurance provided for packaged account holders increased and the inclusion of Post Office service charges which were previously captured within operating expenses.

Combined BaCB and Legacy portfolios non-interest income has reduced by £3.4m to £17.7m (2016: £21.1m). Fee income has reduced year on year following simplification of transactional services offered and the continued reduction in the size of the balance sheet.

Optimum non-interest income reduced by £1.3m from £1.1m, resulting in a £0.2m non-interest expense. 2016 included £1.3m of accounting adjustments, which were one-off in nature and did not reoccur in 2017.

Treasury non-interest income increased by £7.7m to £18.8m (2016: £11.1m).

- hedge accounting volatility resulted in an increase of £14.5m on the comparative year, primarily reflecting the reduction in basis exposure in the cash flow hedges; partially offset by;
- lower levels of recognised gains on disposal of investment securities, which reduced from £18.4m in 2016 to £12.4m in 2017.

Other non-interest income/(expense) has reduced by £6.4m to a £0.5m expense following the non-recurrence of prior year one-offs including a £7.3m recovery from a third party in relation to Payment Protection Insurance (PPI) redress paid to customers within a portfolio of purchased credit cards, and other prior year reporting adjustments.

Impairment gains / losses on loans and advances
Total impairment writebacks of £1.1m in 2017 compares with £2.3m of total impairment losses in 2016.

Retail impairment charge in 2017 of £9.1m is £8.6m higher than prior year. The 2016 impairment charge was suppressed by gains in the loan portfolio driven by a material one-off debt sale. During 2017, provision coverage in the secured portfolio increased to reflect the growth in the Platform portfolio.

Legacy portfolio impairment release in 2017 of £4.4m is £5.6m favourable to last year. The improvement is primarily driven by a writeback of £6.6m associated with a Corporate asset following a material improvement in the underlying asset value.

The Optimum impairment release of £5.6m includes a £3.0m release in relation to Warwick Finance Three.

A more detailed analysis of impairments is provided in the Risk Management section.

Operating expenses
Operating expenditure has reduced by £55.7m to £389.1m (2016: £444.8m), reflecting progress against the Group's cost reduction targets and a significant number of one-off impacts.

Permanent staff numbers (full time equivalents, FTE) have reduced by 428 to 3,177 in 2017 (2016: 3,605) along with a significant reduction in the number of short to medium term specialist contractors when compared to the end of 2016 (falling from 50 to 33 FTE). Temporary staff numbers reduced by 169 to 71 at 31 December 2017 (2016: 240).

Operating staff costs have reduced by £35.1m to £152.6m (2016: £187.7m). This reduction is primarily driven by:

- 2017 saving initiatives of £25.7m as a result of restructuring across the Group (including savings resulting from restructuring activity that occurred at the end of 2016); and
- annualised impact of 2016 cost savings including branch transformation and other restructuring, plus lower FTE due to attrition and recruitment delays has further reduced 2017 spend by £15.0m when compared with 2016; partially offset by increases in staff costs due to insourcing of activity in areas such as Risk and IT.

Non-staff operating costs have reduced by £20.6m to £236.5m (2016: £257.1m). This reduction is driven by:

- A £5.1m increase in one-off cost credits, with £7.9m of one-offs in 2017 (2016: £1.2m) including:
  - Research & Development (R&D) expenditure credits (£5.7m),
  - Optimum fraud provision release (£2.5m),
  - reclassification of release relating to previous Optimum deleverage (£1.1m); offset by,
  - costs to mobilise restructuring activities (£2.2m), and;
  - costs associated with creation of the Silk Road Finance Number Four plc securitisation vehicle (£2.0m);

- 2017 saving initiatives of £33.9m, including targeted third party savings (£11.4m), Estates savings driven by delivery of premises strategy (£6.0m), a marketing spend reduction (£3.0m), savings on IT licenses and maintenance (£3.1m), capitalisation of expenditure under model risk performance (£1.2m), small change savings (£1.0m), and a large number of savings initiatives individually less than £1.0m (£8.2m);
- £3.8m lower recurring costs relating to the FSCS levy reflecting latest guidance from FSCS; and
- year on year spend has increased in 2017 by £22.2m due to additional spend including third party IT (£16.5m), IT refresh and maintenance (£7.0m), and other small items (£5.9m), partially offset by annualised impact of 2016 savings (£7.2m).

Project expenditure

Total project expenditure excluding severance reduced by £221.2m to £88.3m (2016: £309.5m). Project expenditure includes the costs relating to permanent, contract or temporary resource costs working on these projects.

Operating project expenditure for the year reduced by £20.3m to £13.6m (2016: £33.9m). The reduction relates primarily to the conclusion of a number of projects during 2016. The 2017 expenditure largely comprises £12.5m of depreciation (2016: £14.4m).

Remediation project expenditure for the year reduced by £90.4m to £50.9m (2016: £141.3m) and comprises:

- completion of the substantial milestone of data centre migration in H1 2017 (£10.0m);
- ongoing Core IT initiatives (£15.4m) (including Desktop £8.1m and Telephony £3.0m);
- several other smaller projects (£20.4m); and
- depreciation cost for previous investments £5.1m.

The primary drivers for the reduction between 2016 and 2017 remediation costs are:

- a £79.1m reduction in data centre migration expenditure;
- lower data remediation project costs of £9.8m; and
- a reduction in spend on other smaller projects of £7.6m; partially offset by the commencement of the next stage of Cheque Image £3.6m and remaining application data centre migration £2.5m in 2017.

Strategic project expenditure for the year reduced by £110.5m to £23.8m (2016: £134.3m). This reflects a smaller portfolio of ongoing projects compared to 2016. The year on year reduction was driven by:

- non-recurring spend in 2017 relating to the delivery of prior year branch transformation projects (£11.9m);
- cessation of any further spend and the write-off of mortgage process transformation with a third party servicer in 2016 (£81.7m);
- reduced digital activity (£14.7m); and
- a reduction in spend on other smaller projects of £8.6m, partially offset by an increase in depreciation of £6.4m for previous investments.

Severance

The severance charge in respect of the ongoing organisational design changes reduced by £14.5m to £7.0m (2016: £21.5m).

Conduct risk

The 2017 charges relating to conduct risk increased by £2.5m to £27.4m (2016: £24.9m). The 2016 charge includes £0.2m of legal risk, which is now classified under fraud within operating expenditure.

An additional provision of £38.5m was recognised in the year (2016: £36.0m), in respect of the total expected cost of carrying out work and paying compensation related to historical PPI selling. The provision increase reflects increased complaint volumes ahead of the FCA imposed timebar of August 2019, the impact of marketing campaigns and the requirement to mail all previously rejected Plevin complaints.

As at 31 December 2017 the Group had substantially completed its Consumer Credit Act (CCA) proactive redress programme. The 2017 net CCA charge was £0.1m following near-completion of the programme with the remainder of the provision required to complete final system fixes and redress accounts becoming non-compliant prior to implementation. This work is expected to be completed in H1 2018.

Overall conduct provision releases relating to mortgages were £9.6m. The legacy system issues uncovered in the previous year have been actively investigated. Following detailed review and analysis of the issue the overall impact to the Group has been significantly reduced. This predominantly relates to the incorrect customer monthly mortgage payment calculation resulting in the under or overpayment of interest or capital.

Other exceptional items and fair value unwinds

Other exceptional items of £431.0m comprises a net gain of £397.8m generated on the repurchase of the subordinated debt as part of the Restructuring and Recapitalisation, less £41.5m of costs associated with the transaction, a £51.9m gain relating to the change in index used to determine increases for pensions in payment from the Britannia Pension Scheme (as outlined above) as well as a £22.8m credit relating to the sale of the shares in VocaLink. The 2016 amount of £58.1m relates to the sale of the Visa Europe share.

Fair value unwinds reduced by £129.8m following maturity of Leek Finance Number 17 plc and Leek Finance Number 18 plc in 2016 and Leek Finance Number 19 plc in June 2017. The 2017 fair value charge of £50.7m includes a £10.0m release relating to Warwick Finance Three. Fair value unwinds are now complete.

Summary balance sheet

	2017 £m	Re-presented 2016[1] £m	Change
Retail	**14,705.8**	14,844.6	(138.8)
BaCB	**308.5**	434.9	(126.4)
Legacy	**1,099.4**	1,471.4	(372.0)
Optimum	**585.7**	2,605.8	(2,020.1)
Treasury	**7,258.3**	7,615.5	(357.2)
Other	**532.4**	437.5	94.9
Total assets	**24,490.1**	27,409.7	(2,919.6)
Retail	**18,388.5**	19,405.1	(1,016.6)
BaCB	**2,125.1**	2,719.3	(594.2)
Legacy	**99.0**	61.3	37.7
Treasury	**2,088.1**	3,562.5	(1,474.4)
Other[2]	**283.8**	703.0	(419.2)
Total liabilities	**22,984.5**	26,451.2	(3,466.7)
Total equity[2]	**1,505.6**	958.5	547.1
Total liabilities and equity	**24,490.1**	27,409.7	(2,919.6)

1. Re-presentation detailed on page 20.
2. There is a difference of £0.1m between the Group and Bank other liabilities and equity results. This relates to cash held by the Bank Company on behalf of the Holding Company.

Total assets reduced by £2.9bn to £24.5bn (2016: £27.4bn) in the year.

Retail assets reduced by £0.1bn to £14.7bn (2016: £14.8bn). Retail mortgages were broadly flat in 2017 with slight reductions in Retail unsecured, however net mortgage lending of £0.2bn was achieved in H2 2017.

Legacy assets reduced by £0.4bn to £1.1bn (2016: £1.5bn) as a result of the targeted deleverage activity in the portfolio.

Optimum assets reduced by £2.0bn to £0.6bn (2016: £2.6bn) in the year, £1.8bn of the reduction was delivered through Warwick Finance Three in October 2017, with the remainder driven by ongoing repayments.

Treasury assets reduced by £0.4bn. Cash balances have increased by £1.2bn in the year. This is driven by a combination of factors, being the proceeds generated from Warwick Finance Three, the £250m of new share capital raised in the Restructuring and Recapitalisation and sales of high quality liquid assets (HQLA) during the year, partially offset by the impact of withdrawals of customer deposits and the repayment of the £0.4bn Euro Medium Term Note (EMTN). Other liquid asset balances have decreased by £1.0bn following the aforementioned HQLA sales, RMBS balances have fallen by £0.4bn as a result of sales during the year and natural pay down. Other Treasury assets reduced by £0.2bn.

Total liabilities reduced by £3.5bn in the year.

Retail liabilities saw an overall reduction of £1.0bn. Retail current account balances remained stable at £4.2bn. The primary driver of the reduction is Retail Fixed Term Deposit and Fixed Term ISA balances reducing by £1.1bn, as a significant proportion of these balances mature from their fixed periods each year and a proportion of customers choose to invest their funds with other providers. Whilst the Group proactively retained a moderate proportion of these maturing balances across Q2 and Q3, it has managed these deposit levels down in Q4 following the completion of Warwick Finance Three.

BaCB balances have reduced by £0.6bn in the year, predominantly during H1 2017 as customers withdrew balances attributed to a response to uncertainty at the time of the Restructuring and Recapitalisation.

Treasury liabilities reduced by £1.5bn, as a result of the maturity of the £0.4bn EMTN, the £0.5bn maturity of Leek Finance Number 19 plc, the extinguishment of £0.5bn of subordinated debt as part of the Restructuring and Recapitalisation and the repayment of £0.1bn of Calico notes following a regulatory call.

Re-presentation

The 2016 income statement includes a reclassification of a £0.5m gain on sale of residential mortgage backed securities (RMBS) assets from Treasury losses/gains on asset sales to Treasury non-interest income. This reclassification has been made for consistency of classification with other Treasury asset sales, which are recorded within non-interest income.

The 31 December 2016 balance sheet includes a number of reallocations between operating segments following progress made in the Group's transformation of finance processes (see note 3 to the consolidated financial statements for full segmental balance sheet). This has resulted in a reallocation of £0.1bn of previously unallocated assets and £0.2bn of Optimum assets to the Other business unit. Furthermore, £0.5bn of previously unallocated liabilities have been reallocated into the Other business unit. These reallocations reflect the way in which the business was managed during 2017. Following a review of documentation, obligatory netting arrangements were found to be in place for repo and reverse repo transactions. As a result the prior year Treasury assets and liabilities have been re-presented and reduced by £0.2bn.

		Re-presentation				
2016	Prior basis £m	Other assets reallocation £m	Other liabilities reallocation £m	Treasury gain on sale £m	Treasury re-presentation £m	Current basis £m
Income statement						
Treasury net interest income	8.5	-	-	-	-	8.5
Treasury loss/(gain) on asset sale	0.5	-	-	(0.5)	-	-
Treasury non-interest income	10.6	-	-	0.5	-	11.1
Treasury operating income	19.6	-	-	-	-	19.6
Balance sheet	£bn	£bn	£bn	£bn	£bn	£bn
Unallocated assets	0.1	(0.1)	-	-	-	-
Optimum assets	2.8	(0.2)	-	-	-	2.6
Other assets	0.1	0.3	-	-	-	0.4
Treasury assets	7.8	-	-	-	(0.2)	7.6
Unallocated liabilities	0.5	-	(0.5)	-	-	-
Other liabilities	0.2	-	0.5	-	-	0.7
Treasury liabilities	3.7	-	-	-	(0.2)	3.5

Franchise KPIs

	2017	2016	Change
Retail current accounts (000s)	**1,393**	1,435	(42)
Retail prime current accounts (000s)	**648**	664	(16)
Current account NPS	**20**	17	3

Retail current account volumes have reduced by 42,000 in 2017. The number of new accounts opened in the year was 52,000 (2016: 76,000) with closures of 94,000 (2016: 69,000). Following the completion of the Restructuring and Recapitalisation, the number of prime current accounts remained broadly flat in H2 2017 despite a time of intense switching competition.

Current account NPS (6 month rolling average) increased from 17 to 20. The Group remains third in market.

	2017	2016	Change
Mortgage completions (£bn)	**3.2**	3.1	0.1
Mortgage redemptions (£bn)	**2.7**	1.7	1.0

2017 mortgage completions increased by £0.1bn to £3.2bn (2016: £3.1bn). The Group's intermediary channel, Platform, accounted for 97% of new business completions, up from 91% in 2016, as more UK consumers continue to opt to utilise mortgage brokers. Mortgage redemptions increased by £1.0bn in 2017 to £2.7bn (2016: £1.7bn) driven by higher volumes of customers reaching the end of the fixed rate period and the availability of competitive market-wide refinancing rates, which have resulted in an increase in the volume of customers choosing to refinance with other providers.

The Group delivered £1.9bn of the 2017 completions in H2 2017 as it deployed the liquidity generated from Warwick Finance Three.

Capital and liquidity

Liquidity Portfolio

Liquidity resources, as at 31 December 2017, increased from £8.2bn to £10.0bn and continued to be in excess of minimum regulatory requirements. As at 31 December 2017 the liquid asset ratio was 18.7% (2016: 13.9%).

Primary liquidity has increased by £0.8bn to £4.6bn (2016: £3.8bn) and secondary liquidity has increased by £1.0bn to £5.4bn (2016: £4.4bn). Primary liquidity consists of liquid assets that are eligible under European Banking Authority (EBA) regulations (High Quality Liquid Assets). The increase in primary liquidity related mainly to the completion of the £1.8bn Warwick Finance Three transaction in October 2017 and the £250m inflow arising from the equity issuance under Restructuring and Recapitalisation, partially offset by the £0.4bn EMTN maturity in September 2017. Secondary liquidity comprises unencumbered investment securities not included as part of primary liquidity, as well as mortgage and corporate collateral eligible for central bank facilities. The increase in secondary liquidity is a combination of the increase in the collateral eligible for central bank facilities, partially offset by mortgage redemptions, amortisation and sale of retained securities, and management of secured funding collateral requirements.

£m unless stated	**As at 31 December 2017**	As at 31 December 2016	Change
Operational balances with central banks	**3,815.5**	2,571.4	1,244.1
Gilts	**423.1**	676.2	(253.1)
Central government and multi-lateral development bank bonds	**348.7**	568.5	(219.8)
Total primary liquid assets	**4,587.3**	3,816.1	771.2
Other liquid assets	**1,186.1**	727.2	458.9
Contingent liquidity	**4,191.8**	3,697.0	494.8
Secondary liquidity	**5,377.9**	4,424.2	953.7
Total liquidity	**9,965.2**	8,240.3	1,724.9
Average balance	**9,151.5**	9,061.2	90.3

Liquidity Coverage Ratio (%)	**213.0%**	213.5%	(0.5%)
Loan to Deposit Ratio (%)	**81.1%**	86.7%	(5.6%)
Encumbrance Ratio (%)	**15.1%**	17.8%	(2.9%)

Capital

Capital resources CRD IV

	31 December 2017 £m	31 December 2016 £m
Common Equity Tier 1 (CET1): instruments and reserves		
Permanent share capital and the related share premium account	**314.7**	1,759.5
Retained earnings	**(1,315.1)**	(896.4)
Available for sale and cash flow hedge reserves	**55.0**	94.6
Defined benefit reserves	**70.8**	9.5
Other reserves[1]	**2,147.5**	410.0
Independently reviewed profits net of any foreseeable charge or dividend	**232.7**	-
CET1 before regulatory adjustments	**1,505.6**	1,377.2
CET1: regulatory adjustments		
Prudent valuation	**(1.5)**	(5.4)
Intangible assets (net of deferred tax liability)	**(81.5)**	(100.1)
Defined benefit pension (net of deferred tax liability)	**(118.3)**	(15.3)
Deferred tax assets not arising from temporary differences	**(4.2)**	-
Cash flow hedge reserves	**(29.9)**	(56.4)
Expected loss shortfall	**(14.5)**	(44.4)
Losses for the period	**-**	(418.7)
Total regulatory adjustments to CET1	**(249.9)**	(640.3)
CET1	**1,255.7**	736.9
Additional Tier 1 (AT1) capital: instruments	**-**	-
Total regulatory adjustments to AT1 capital	**-**	-
Total Tier 1 capital (T1 = CET1 +AT1)	**1,255.7**	736.9
Tier 2 (T2) capital: instruments and provisions		
Capital instruments	**-**	447.0
Credit risk adjustments	**-**	-
T2 capital before regulatory adjustments	**-**	447.0
Total regulatory adjustments to T2 capital	**-**	-
T2 capital	**-**	447.0
Total capital (TC = T1 + T2)	**1,255.7**	1,183.9

1. Other reserves include the capital redemption reserve and capital re-organisation reserve created as a result of the Bank's Liability Management Exercise in 2013 and the Restructuring and Recapitalisation in 2017 respectively.

The Group's consolidated Common Equity Tier 1 (CET1) post regulatory deductions has increased from £736.9m to £1,255.7m at 31 December 2017.

The Restructuring and Recapitalisation generated additional CET1 resources of £712.5m (before costs of £63.3m) and the elimination of £447.0m of Tier 2 resources.

The new CET1 resources can be summarised into the following categories:

- new permanent share capital and related share premium - £314.7m made up of £0.2m of initial subscriptions upon the incorporation of Co-operative Bank Holding Company, new equity investment of £250m and equity awarded to non-Retail Tier 2 noteholders of £64.4m; and

- retained earnings - £397.8m gain on the extinguishment of the Tier 2 debt obligations in the Group. In addition, £41.5m costs related to the Restructuring and Recapitalisation recorded in the income statement, with the residual £21.8m recorded in equity.

A capital re-organisation reserve of £1,737.5m was created as part of the Restructuring and Recapitalisation which reflects the difference in the consideration paid by the Holding Company for The Co-operative Bank plc and The Co-operative Bank plc share capital and share premium and is included in other reserves.

Expected loss shortfall has reduced due to the continued deleveraging of the Legacy portfolio and reduction in the Optimum portfolio together with the removal of the expected loss Temporary Model Adjustment (TMA).

During the year, the net retirement benefit asset relating to the Britannia Pension Scheme (BPS) increased by £137.4m to £157.7m. The movement in the asset value was due to actuarial gains of £81.6m (recognised in the defined benefit pension reserve), a £51.9m gain in respect of the switch to CPI for inflationary increases (recognised in retained earnings) and £6.0m of employer cash contributions to the scheme in respect of deficit recovery contributions and expense reimbursement, partially offset by a £2.1m net charge in respect of other items (also recognised in retained earnings). CET1 resources are impacted only by the £6.0m of cash contributions to the scheme, which drives an increase in the pension asset (which is deducted for regulatory capital purposes) with no corresponding increase in equity. The other movements detailed above have no direct impact on CET1 resources (before tax), due to the equal and opposite impact on the equity and pension scheme asset positions.

The Group is able to recognise deferred tax assets (DTAs) to directly offset deferred tax liabilities associated with the net retirement benefit asset. The nature of these DTAs is such that they are allowable for recognition in CET1, driving a net £34.4m increase in CET1.

Transition to IFRS 9 on 1 January 2018 is not expected to have a significant impact to capital.

Capital ratios and Risk Weighted Assets (RWAs)

	31 December 2017	31 December 2016
Capital ratios		
Common Equity Tier 1 ratio	**24.7%**	11.0%
Tier 1 ratio	**24.7%**	11.0%
Total capital ratio	**24.7%**	17.7%
Leverage ratio common disclosure		
Tier 1 capital	**1,255.7**	736.9
Total leverage ratio exposures	**25,792.4**	28,399.7
Leverage ratio	**4.9%**	2.6%
Risk Weighted Assets		
Credit risk	**4,449.6**	5,944.0
Market risk	**-**	-
Operational risk	**636.0**	732.1
Total risk weighted assets	**5,085.6**	6,676.1
Segmental analysis of credit risk RWAs		
Retail	**1,949.0**	1,919.9
Optimum	**335.8**	899.8
BaCB	**372.7**	485.3
Legacy Portfolio	**870.2**	1,140.6
Treasury	**495.8**	1,017.6
Other	**426.1**	480.8
Total credit risk RWAs	**4,449.6**	5,944.0

Total RWAs have decreased by £1,590.5m in the year.

Credit risk RWAs reduced by £1,494.4m in 2017.

During 2017 the Group was informed by the Prudential Regulation Authority (the PRA) that Calico Finance Number One Limited (Calico) did not achieve significant risk transfer (SRT) to third parties as defined within the Capital Requirements Regulation. As a consequence, no RWA benefit was received from the Calico transaction. Following this SRT determination and the demonstrable adverse effect on the capital position, the PRA were requested to consent to the exercise of the regulatory call of the Calico Notes. The Group received confirmation in writing that the PRA had no objection to the Group effecting a regulatory call of Calico, subject to the transaction's terms and conditions. Accordingly, a regulatory call was exercised of notes issued by Calico under the Credit Default Swap Agreement entered into between the Group and Calico, resulting in the redemption of the Calico Notes in September 2017. Following this, Optimum RWAs increased by £0.8bn, as the assets were re-recognised as internal ratings basis (IRB) mortgage assets, and remain the primary driver of the reduction in Treasury RWAs, as the securitisation risk weighted assets associated with Calico are no longer recognised.

The increase in Optimum RWAs following the call of Calico (£0.8bn) has been more than offset following the completion of Warwick Finance Three (£0.9bn) and the removal of a £0.3bn temporary model adjustment in H1 2017 resulting in an overall reduction in Optimum RWAs of £564.0m. Legacy RWAs have fallen by £270.4m as a result of the continued deleveraging activity within the portfolio.

The movements in capital resources and RWAs outlined above are the primary factors resulting in:

- the CET1 ratio increasing by 13.7% from 11.0% to 24.7%;
- the leverage ratio increasing from 2.6% to 4.9%; and
- the total capital ratio increasing from 17.7% to 24.7%.

Individual Capital Guidance
The Group received an updated ICG letter from the PRA in December 2017. As at 31 December 2017, the Group had Pillar 1 requirements equivalent to 8.0% of total RWAs and a Pillar 2a requirement equivalent to 10.0% of total RWAs (14.5% at 31 December 2016). The Group meets the total 18.0% of RWAs (or £917.4m) ICG requirement with CET1, as it no longer holds Tier 2 capital resources following the Restructuring and Recapitalisation. The Group has a combined buffer requirement of 1.25% of RWAs (or £63.6m) above the ICG requirement.

At 31 December 2017 the Group had CET1 resources post regulatory deductions of £1,255.7m and therefore reported a surplus to ICG of £338.3m and a surplus to the combined buffer requirement of £274.7m.

SOCIAL, COMMUNITY AND HUMAN RIGHTS

On 1 September 2017, the governance structure of the Group was amended to reflect the Bank becoming a wholly owned subsidiary of the Holding Company. The narrative below is written with reference to the Bank; however, information reported in the following section reflects the activities of the Bank and Group collectively.

Our Values, Ethics and community impact

The Co-operative Bank brand is defined by Values and Ethics, which represent a clear point of difference that has set us apart from our competitors since 1992, when we were the first bank in the UK to launch a customer-led Ethical Policy. Today's policy has evolved through five comprehensive reviews, all of which have been based on consultation with a total of over 320,000 customer and colleague views. In 2015 the Policy was extended to include five key pillars, which guide and shape all aspects of our business, from our impact on the environment, the products and services we offer, the relationships we have with suppliers and colleagues, to the campaigns we support and our involvement in local communities. This enables us to stay true to our customers', colleagues' and stakeholders' aspirations to deliver a differentiated ethical banking service. Our commitment to screen every new non-personal account remains a cornerstone of our Ethical Policy, ensuring we don't lend customers' money to organisations that are in direct conflict with the issues that matter to our customers as outlined in the Ethical Policy. During 2017 we declined banking services to five businesses as a result. In 2017, we marked 25 years of our Ethical Policy and reminded customers of why it is important and what it has achieved, through a customer communications campaign.

Following the completion of the Restructuring and Recapitalisation, the Ethical Policy continues to be reflected in the Articles of Association of the Bank and Group and the delivery of the Policy is overseen by the Values and Ethics Committee of the Board.

The impact of our charity partnerships

In 2017 we formed a partnership with the UK's leading youth homelessness charity, Centrepoint and our customers and colleagues have raised over £450,000 in support of the charity during the year. This includes £363,000 through donations linked to our mortgage products and current account switching campaign. The partnership with Centrepoint has allowed the charity to launch its first UK-wide telephone helpline, for young adults who are at risk. In addition, the Bank has helped fund a new support centre in Manchester, which is open to homeless young adults. The Bank also sponsored the Manchester Sleep Out fundraising event with almost 100 Bank colleagues taking part. Through this and other activities, Bank colleagues and customers raised a total of £68,723.

"Centrepoint's partnership with The Co-operative Bank is hugely important for our organisation and the young people we are now able to reach thanks to the generous support of your organisation, colleagues and customers. In 2017 Centrepoint began working with young people in Manchester, and as our first partner in the area, The Co-operative Bank has been instrumental in enabling us to implement a range of services designed to support some of the more vulnerable members of our society. Our partnership has also had a national reach, allowing us to further develop the first, dedicated helpline for young people who are either experiencing or at risk of homelessness – a service that will now both operate as a telephone helpline and online platform to make it as accessible as possible for the young people it serves.

Centrepoint is incredibly grateful to The Co-operative Bank, its colleagues and customers for their incredible support of our partnership in 2017 and look towards the future as we work together to tackle the issue of youth homelessness and support more young people to achieve positive outcomes."

Seyi Obakin OBE, Chief Executive, Centrepoint

Our Everyday Rewards scheme allows eligible current account customers to donate their monthly earned rewards to one of five charity partners. These customer donations raised almost £175,000 in 2017.

In addition, through the actions of our colleagues and a match funding element from the Bank, we donated over £35,000 to another 30 local and national charities and donated £45,000 to local and national campaigns, including £25,000 to the British Red Cross UK Solidarity fund and £20,000 to Co-operatives UK Hurricane Appeals, providing help and support to co-operatives in the Caribbean and Asia to recover following devastating storms.

Our colleagues volunteer in their communities

Our employee volunteering programme is a key element of our community engagement and in 2017 we saw an increase in colleague volunteering activity. We encourage all colleagues to take part in team challenges or volunteer on an individual basis with community organisations and charities. In 2017, 887 colleagues volunteered 5,559 hours to their local communities, carrying out 84 team challenges along with individual volunteering placements.

Our volunteering programme benefited people in many communities across the UK during 2017. Our colleagues made a difference supporting community organisations, working with the long term unemployed, supporting children with their literacy and numeracy skills, and protecting the environment.

Our work in support of vulnerable customers

The Co-operative Bank has been working in partnership with Citizens Advice Manchester to provide support services to their most vulnerable customers. The aim of the partnership is to ensure that our most vulnerable customers can access responsive services that will assist them in addressing immediate financial difficulties and support them to manage their finances in the long term.

These customers are often distressed when they call and need immediate support in order to avert potential problems with third parties for example, landlords or bailiffs. As a result they need a speedy service that can help them navigate the often complex problems they face. Since the project was launched in 2016 almost 750 customers have received support through this programme, with Citizen's Advice Manchester resolving almost 1,800 problems for these customers.

"We are delighted to be working with The Co-operative Bank to help customers get access to the advice they need. The partnership we have developed enables us to intervene early before problems escalate. Supporting people to get their finances back on track, helping families to stay in their homes and access other essential services."

Hayley Hughes, Business Development Manager, Citizens Advice Manchester

Supporting co-operatives to grow through our partnership with The Hive

Supporting the co-operative movement remains integral to what we do. We are proud to be supporting 'The Hive', a unique business support programme run by Co-operatives UK, for people keen to start or grow a co-operative or community enterprise. The Hive launched in 2016 following a £1m 3-year sponsorship from the Bank. Through a range of online resources, advice and training, The Hive is helping to build more and better co-operative businesses across the UK.

During 2017 The Hive supported over 355 groups and co-ops with expert advice worth over £100,000. It helped 10 communities to raise over £2million from local people and take ownership of vital assets and services. During 2017 more than 10,000 employees, volunteers, Board members and members benefited from Hive support. The Hive's free online resources, guides and films were seen over 328,000 times.

"Through the Bank's support for The Hive we have been able to demonstrate co-operative ownership can improve people's lives, whether offering a secure alternative to the rise in precarious work or helping communities take control of the things that matter to them. By promoting co-operative approaches and backing that up with specialist advice and support, The Hive is helping to create a new wave of co-ops."

Ed Mayo, Secretary General of Co-operatives UK

"It was great and very well timed to have the support from The Hive. Our Governance procedures are now much more robust and there's greater confidence in our processes. We don't work like a typical business or a typical structure or a workplace. We do it together. Being a co-op means we can reflect everybody that's within it – everybody's views have an opportunity to be aired and the decisions we make are very much the collective will of all of us."

Kaleb Debbage, Workshop Manager, Bristol Wood Recycling Project

Our commitment to the co-operative sector goes beyond our relationship with Co-operatives UK and our sponsorship of The Hive programme. We continue to support co-operatives, charities and social enterprises through the provision of dedicated bank accounts and lending facilities.

In 2017 lending to co-operatives and mutuals totalled £22.8m (2016: £30.4m) and 47% of business deposits and 40% of business loans are provided to customers whose business delivers a positive social and environmental impact.

We remain a supporter of Credit Unions and continue to be the largest provider of banking facilities to this sector in the UK. Around 55% of UK Credit Unions have an account with The Co-operative Bank.

Environmental protection and greenhouse gas (GHG) reporting

Protecting the environment (including tackling climate change) is one of the key commitments of our customer-led Ethical Policy. As a result we do not lend to businesses or projects that conflict with our environmental sustainability commitments, reflecting our customers' concerns about the environmental impact of doing business. In 2017, we declined banking services to one business involved in the provision of strategic services to the oil and gas sector which were considered intrinsic to the extraction process.

We also seek to minimise the Bank's environmental impacts. We continued to source the majority of our electricity from renewables in 2017, and maintained our 'beyond carbon neutral' status for the ninth consecutive year, offsetting our operational greenhouse gas (GHG) emissions[1] plus an extra 10% which addresses the impact our business has had on historical CO_2 emissions. We do this by supporting carbon reduction projects, identified through climate and development experts ClimateCare.

As well as offsetting our carbon emissions, these projects provide additional benefits for people and the environment around the world. One example is our support for the LifeStraw water filter project. In total, this project cuts 2.4m tonnes of CO_2 emissions annually and brings safe drinking water to more than 4.5m people in Western Kenya. Some 877,505 families use LifeStraw Family water filters to purify water in their home, rather than boiling water for drinking over open fires.

We have reported our GHG emissions for more than 19 years, measured in carbon dioxide equivalent (tCO_2e) using the UK Government guidance[2]. Our direct GHG footprint encompasses energy consumption, refrigerant leakages from our premises and all business travel (air, rail and road). All greenhouse gas data and related commentary is externally assured[3].

Total GHG emissions by source

Source of emissions	Total emissions (tCO_2e) 2017	2016
Fuel combustion	**1,804**	2,009
Electricity consumption [4,5]	**12,497**	16,182
Refrigerant leakages [6]	**397**	185
Business travel	**790**	1,183
Total	**15,488**	19,559
Carbon intensity (tCO_2e/FTE[7])	**4.2**	4.41

1. Remaining emissions from gas, brown electricity, business travel and major occupancy refrigerants once green electricity supply is discounted.
2. Department for Environment, Food and Rural Affairs (DEFRA), Environmental Reporting Guidelines: including mandatory greenhouse gas emissions reporting guidance, June 2013. www.gov.uk/government/uploads/system/uploads/attachment_data/file/206392/pb13944-env-reporting-guidance.pdf. Since 2013 all UK quoted companies have been required to report on their GHG emissions as part of their Annual Report and Accounts. (The Companies Act 2006 (strategic report and Directors' report) Regulations 2013)
3. DNV GL has provided limited assurance of the GHG data for the purpose of the Annual Report and Accounts.
4. If electricity from renewable sources is accounted as zero carbon then emissions from electricity would be 162 tCO_2e.
5. GHG emissions per unit of electricity are calculated by DEFRA and updated annually.
6. Refrigerant gas data includes major occupancy properties only.
7. Average number of full time equivalent (FTE) employees for the year.

Modern slavery and human trafficking statement

We are committed to ensuring that our business, and our suppliers, are free from modern slavery and human trafficking, upholding the principles of our Ethical Policy. Our Modern Slavery and Human Trafficking statement sets out the steps we're taking to prevent modern slavery and is published on our website (http://www.co-operativebank.co.uk/aboutus/ourbusiness/Human-Trafficking-Statement).

Corporate Governance

PREFACE TO THE CORPORATE GOVERNANCE SECTION

On 1 September 2017, the governance structure of The Co-operative Bank plc (Bank) changed as a result of it becoming a wholly owned subsidiary of The Co-operative Bank Holdings Limited (Holding Company). The Holding Company was incorporated as Balloon Street Holdings Limited on 13 July 2017 and changed its name to The Co-operative Bank Holdings Limited on 1 September 2017.

While the committees of the Board of the Holding Company came into being and members were appointed on 26 September 2017, they were not formally constituted, and their roles and responsibilities agreed, until their Terms of Reference were approved on 17 November 2017. Hence the 2017 Annual Report and Accounts do not include any reports on the activities of the committees of the Board of the Holding Company.

The information reported in the following sections reflects the governance arrangements of the Bank, with reference to the Holding Company where relevant.

BIOGRAPHIES OF THE BOARD

Non-Executive Directors

Dennis Holt – Chairman
Independent: On appointment
Committee membership: Nomination (Chair), Audit, Values and Ethics

Dennis joined the Bank Board in February 2014 as Senior Independent Director. He was appointed as Chairman on 27 October 2014. Dennis' experience in banking and insurance spans 46 years and includes a period as Main Board Executive Director at Lloyds TSB Limited responsible for the Retail Bank. He has held several Non-Executive posts including Deputy Chairman of Bank of Ireland, Chairman of Bank of Ireland (UK) PLC and Chairman of Liverpool Victoria. He is currently Non-Executive Chairman of Beazley plc and its subsidiary Beazley Furlonge Limited. He is due to stand down from his Chairman role at Beazley plc's Annual General Meeting on 22 March 2018.

Dennis will step down as Chairman of both the Bank and the Holding Company and retire from both Boards on 14 March 2018.

Robert Dench - Non-Executive Director
Independent: Yes
Committee Membership as of 14 March 2018: Nomination (Chair), Audit, Values and Ethics

Bob Dench has enjoyed a long career in banking, and has been Chair of Paragon Banking Group PLC since 2007, having joined its Board in 2004. He chaired Paragon through the financial crisis and oversaw a reconfiguring of the business model as Paragon obtained its banking licence. Previously, he served on the boards of AXA UK and Ireland from 2004, as Senior Independent Director of AXA UK until December 2016 and Chair of AXA Ireland from 2007 to 2017. He was also Chair of AXA PPP Healthcare Limited from 2013 to 2017. Prior to that, he spent 28 years at Barclays, in a number of senior executive roles across the group in the UK, US and Australia.

Aidan Birkett – Senior Independent Director
Independent: Yes
Committee Membership: Audit, Nomination, Remuneration

Aidan joined the Bank Board in July 2015. He built his career within the professional services sector over more than 30 years with Pricewaterhouse Coopers LLP and Deloitte LLP. He was head of Deloitte's Corporate Finance business and a member of the firm's Executive Committee.

He has led a number of high profile strategic and commercial reviews of businesses in varying turnaround situations, in the UK and overseas. This has provided him with significant experience in the wholesale finance sector and an understanding of the Retail customer segment across a number of non-financial sectors. Aidan has served as a consultant, Director and advisor in various capacities and has held various Non-Executive Director roles. He is currently a Non-Executive Director with the Dubai Group.

Aidan will step down from the Board of both the Bank and Holding Company and their Committees on 14 March 2018.

Glyn Smith - Non-Executive Director
Independent: Yes
Committee membership: Audit (Chair), Risk, Values and Ethics

Glyn joined the Bank Board in October 2016, becoming Chairman of the Audit Committee on 26 October 2016. He has over 35 years' experience in the financial services sector, most notably in a number of senior Executive roles in Barclays Bank and as Group Finance Director of the Portman Building Society. Since 2003, he has held numerous Non-Executive Directorships and chaired the Audit Committees of organisations across both the public and private sectors. These have included Coventry Building Society, Domestic & General Group and Stroud & Swindon Building Society in the financial services sector. Glyn is a graduate of the University of Cambridge and a Chartered Accountant. He was a former member of the examinations team of the Institute of Chartered Accountants in England and Wales (ICAEW). He is currently also a Non-Executive Director and Chairman of the Audit and Risk Committee of Reclaim Fund Ltd.

William Gennydd Thomas – Non-Executive Director
Independent: Yes
Committee membership: Remuneration (Chair), Risk, Nomination

Bill joined the Bank Board in October 2013. He is a former Senior Vice President of Hewlett - Packard and was on the Executive Committee of EDS plc as Executive Vice President. He has IT expertise and is an experienced leader and general manager with a track record in leading major change in large organisations. He has extensive commercial and operational experience, working domestically and internationally with both public and private sector organisations. Bill is a member of the Council, and President of the Alumni Association at Cranfield University School of Management. Bill serves as the Chair of the Royal Navy and Royal Marines Charity and Non-Executive Chair of Spirent Communications plc. Additionally, he is a Director on the Advisory Board of FireEye Inc, the Chair of Node 4 Limited and a partner in Hopton Estates.

Laura Carstensen – Non-Executive Director
Independent: Yes
Committee membership: Values and Ethics (Chair), Remuneration, Risk

Laura was appointed to the Bank Board in May 2014. Laura is a former partner at the City law firm, Slaughter and May Limited. She is a former Member and Deputy Chair of The Competition Commission (now The Competition and Markets Authority) and a former Commissioner of the Equality & Human Rights Commission. She is currently Non-Executive Chair of Park Group PLC, a Trustee of National Museums Liverpool and a member of the Vote 100 Advisory Committee.

Derek Weir – Non-Executive Director
Independent: Yes
Committee membership: Risk (Chair), Audit, Remuneration

Derek joined the Bank Board in July 2014 and was appointed Chair of the Risk Committee on 26 January 2016. He has over 25 years of financial services experience, holding a range of senior positions in corporate and commercial banking. During this time he held posts, both in the UK and internationally, at Barclays Bank plc and Royal Bank of Scotland plc, including being the Managing Director responsible for Commercial Banking in the UK for Royal Bank of Scotland plc. Derek is currently a Non-Executive Director of Motherwell Football Club Community Trust and a Director of Kerrach Limited. Derek is also Non-Executive Director of Halo Urban Regeneration Company Limited.

Charles Bralver – Non-Executive Director
Independent: No
Committee membership: Risk, Values and Ethics, Remuneration, Nomination

Charles Bralver joined the Bank Board in April 2015. He is a Corporate Director and Advisor. He was a founding partner and Vice Chairman of Oliver Wyman and led its Capital Markets, European, and North American practices. He has also served as Senior Associate Dean for International Business and Finance at the Fletcher School of Tufts University, and as a Strategic Adviser to Warburg Pincus LLC. He currently serves as Chairman of the Investment Committee of Infrastructure Fund Ultra Capital LLC and a Director of Canaccord Genuity Group-Toronto. He is also a Senior Advisor to SP Coop Investment, Ltd, a member of Chatham House, Business Executives for National Security, the Senior Advisory Board of Oliver Wyman, the Massachusetts Mass Insight Fin-tech Initiative, and the Board of the Fletcher School of Tufts University. He has an AB from Dartmouth College and an MA and MALD from The Fletcher School.

Executive Directors

Liam Coleman - Chief Executive Officer
Liam became Chief Executive Officer on 1 January 2017 after having been appointed as Deputy Chief Executive Officer on 3 May 2016. Liam was appointed to the Bank Board on 11 July 2016. He joined The Co-operative Bank plc in June 2013 as the Treasurer and subsequently was appointed Director of the Retail & Commercial Bank on 1 September 2014. Liam has 26 years' experience in the industry and prior to joining the Bank Liam was Deputy Group Treasurer and Group Head of Capital Management at the Royal Bank of Scotland Group from February 2011 to June 2013. Liam worked at Nationwide Building Society from 1996 to 2011, ultimately as Group Director, Treasury where he had responsibility for all of the Treasury activities of the society. Earlier in his career, Liam worked at NatWest in corporate banking and at Hambros and Bank of Tokyo-Mitsubishi UFJ Ltd in corporate and structured finance. Liam is a former Non-Executive Director of Great Western Hospitals NHS Foundation Trust.

Tom Wood – Chief Financial and Restructuring Officer
Tom joined the Bank as Chief Restructuring Officer in July 2017 and became a member of the Bank Board on 1 September 2017. He subsequently also became Chief Financial Officer on 22 September 2017. Tom is a former Chief Executive Officer and Chief Financial Officer of Shawbrook Group plc, where he played an integral role leading the business through its successful Initial Public Offering (IPO) and entry into the FTSE 250. Prior to Shawbrook Group, Tom was Chief Financial Officer for NBNK Investment plc and Group Chief Financial Officer of Skipton Group. He began his career in Financial Services with Barclays plc, where he held a number of senior roles in Corporate Development, Finance and Risk. He was subsequently Group Chief Financial Officer of Derbyshire Building Society where he played a key role in its merger with Nationwide Building Society and played a leading role in the restructure of Northern Rock in 2009.

DIRECTORS' REPORT

The Directors of The Co-operative Bank Holdings Limited and The Co-operative Bank plc (the Directors) present their report and audited accounts for the year ended 31 December 2017.

General information

The Co-operative Bank Holdings Limited (Registered number 10865342) and The Co-operative Bank plc (Registered number 990937) and its subsidiaries provide a range of banking and financial services in the United Kingdom. See page 11 for a full description of our business model and focus.

The Bank undertook a Restructuring and Recapitalisation in 2017. As of 1 September 2017, the Bank's sole shareholder is The Co-operative Bank Holdings Limited, which was incorporated as Balloon Street Holdings Limited on 13 July 2017 and is a private company limited by share capital. Of note is that the former significant shareholder, Co-operative Group Limited, reduced its residual holding in the Holding Company to 1% at the completion of the Restructuring and Recapitalisation on 1 September 2017 and has since effected a disposal of this holding.

Dividends

The Directors do not expect to pay dividends in the near future.

Business review, future developments, post balance sheet events and financial risk management objectives and policies

The business review and future developments, key performance indicators, Principal risks and uncertainties and post balance sheet events are referred to in the strategic report starting on page 8. Financial risk management objectives and policies can be found as detailed below:

Going concern

The assessment of the appropriateness of the going concern basis of accounting for The Co-operative Bank Holdings Limited and The Co-operative Bank plc Annual Report and Accounts 2017 has been subject to thorough consideration involving analysis and discussion by management, Executive and Board Committees and the Board, in line with our governance process.

The Directors have assessed the going concern status using a framework focusing on capital, liquidity, performance versus the Bank's Plan and other material issues. After making enquiries of management and considering the Plan, in particular for the 12 month period following the date of approval of the Group and Bank's financial statements, the Directors have a reasonable expectation that the Group and Bank will have adequate resources to continue in business over this period. For these reasons, they continue to adopt the going concern basis in preparing these financial statements. For more details see note 1.2 to the consolidated financial statements.

Political donations

There is a policy that no donations are made for political purposes.

Directors' details

Details of Directors, including appointments and resignations during the financial year, and changes since the end of the financial year are provided on pages 36 to 37 of the Governance section of the report. Details of the Directors offering themselves for election and re-election at the 2018 Annual General Meeting are provided on page 37.

Directors' third party and pension scheme indemnity provisions

Details of insurance and indemnities in place for the benefit of the Directors are provided within the Corporate Governance Report.

Significant contracts

Details of related party transactions are set out in note 32 to the consolidated financial statements, note 5 to the Holding Company financial statements and note 22 to the Bank Company financial statements.

Corporate responsibility

Corporate responsibility activities are outlined on page 25.

CO_2 Emissions

The Greenhouse gas emissions report is detailed on page 26.

Anti-Bribery and Corruption

The Bank is UK based with no global footprint. It is assessed as being an inherently low risk organisation in terms of bribery and corruption, and for 2017 there are no anti-bribery matters to disclose. In accordance with policy, the Bank undertakes anti-bribery and corruption due diligence on new third party suppliers as part of the on-boarding process, which is supplemented by annual due diligence of existing suppliers. This is in line with the Control Standards for Anti-Bribery and Corruption and third party suppliers. No material risks have been identified.

Employees
Significant investment has been committed to a cultural transformation programme since 2015, led by the Chief Executive Officer and Executive team. This commenced with an absolute focus on embedding our new workplace values throughout the organisation in 2015 and 2016 and then a renewed focus on continuing to drive our cultural transformation forward in 2017. Following our successful Restructuring and Recapitalisation in 2017, our workplace values and associated behaviours were refreshed to continue to embed our required culture and help us deliver our Financial Plan.

We remain focused on supporting performance improvement through the provision of high quality mandatory risk, conduct and performance management training to all colleagues. As part of our ongoing focus of improving our processes, the performance management process was refreshed in 2017 and now includes an online system for 2018 to improve consistency and oversight. For 2018, a mandatory leadership objective has been included for all people leaders to improve the focus on embedding the right culture to reflect our values. The Bank has extended its training programmes to include leader masterclasses on performance management to drive this focus. A full modular based programme is available for all our people managers as well as a 'New to leadership' training module.

A key focus during the last year has been the successful Restructuring and Recapitalisation and throughout this period retaining and attracting the right people to take the Bank forward. A successful graduate scheme continues to run with 31 graduates now in the scheme, as well as an apprenticeship offering with 50 colleagues currently in this programme. A robust succession planning process operates, with an even greater emphasis on talent development in 2017.

During 2017, we continued our focus on diversity and inclusion to support our Ethical Policy commitments to both our people and customers. The Diversity and Inclusion Strategy was refreshed with a focus on all demographics and in particular gender, to ensure equality of opportunity regardless of characteristics. We were one of the first companies to sign up to the HM Treasury Women in Finance Charter in 2016 which supports the progression of women into senior management roles. We are doing well against our target to achieve 40% representation of women in our senior roles by 2020. 2017 saw an increase of 2% from our 2016 baseline of 32% and we now have 34% females in our senior roles. We continue to hold relationships with a number of diversity advisory bodies such as Inclusive Employers and Stonewall who provide the Bank with support on diversity.

In January 2015, as part of our new Ethical Policy, we committed to paying colleagues no less than the living wage. We re-affirmed this commitment in 2016 and 2017.

We continue to consult and communicate (using a number of platforms including colleague publications, intranet, surveys, conferences and videos) with colleagues on customer, organisation and business performance issues. In addition, regular informal and formal consultations occur with our Trade Unions. The Unions continue to be fully consulted where organisational change and other issues may affect colleagues.

Employees with disabilities
During 2017, we continued to be a Disability Confident employer (level 2) with commitment to recruit and retain disabled people and people with health conditions for their skills and talent. Interviews are offered to all candidates with a disability who meet the minimum criteria under this commitment. Policies and processes are in place to support disabled colleagues in the workplace and we recognise our responsibility for making reasonable adjustments for new colleagues and for those individuals who develop disabilities whilst in employment. Further guidance and information for colleagues on disability issues is available through Human Resources and on the colleague intranet.

Employees' wellbeing
We recognise that health and wellbeing at work are vital. Wellbeing services include access to an external Employee Assistance Programme (EAP) which provides free expert advice to colleagues on a wide range of matters including health and wellbeing, personal and work related concerns, money and debt, child/elder care and trauma. The EAP offering to colleagues was improved in 2017 and the support available to colleagues is promoted. Occupational health support is also provided.

Corporate Governance report
The Corporate Governance Report can be found on page 34 and, together with this Directors' report of which it forms part, fulfils the requirements of the Corporate Governance statement for the purpose of the Financial Conduct Authority's Disclosure and Transparency Rules (DTR). Each of the persons who is a Director at the date of approval of this Annual Report and Accounts 2017 confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Bank and Bank Company's auditor is unaware; and
- the Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Bank and Bank Company's auditor is aware of that information.

The confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

Ernst & Young LLP have expressed their willingness to continue in office as auditor and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

By order of the Board for The Co-operative Holdings Limited	By order of the Board for The Co-operative Bank plc
Dennis Holt Chairman 13 March 2018	Dennis Holt Chairman 13 March 2018

CORPORATE GOVERNANCE REPORT

Chairman’s introduction

The Bank has been through significant change during 2017. As a result of the Restructuring and Recapitalisation, the governance structure has been modified. Previously, the Bank Board comprised 11 Directors, of whom four were nominated by major shareholders and two were Executive Directors. Now, as described in the Ownership section below, there are separate boards for the Holding Company and Bank Company, albeit with identical membership. These are currently intended to comprise 10 Directors, to include two B Directors nominated by the B shareholders, and two Executive Directors. We expect to complete the transition to this model during 2018.

Despite this change, I am satisfied that we continue to have an appropriate balance of knowledge, skills and independence to carry out the Boards’ responsibilities.

I am pleased that Bob Dench joined the Board as a Non-Executive Director on 1 February 2018 and will become Chairman of both Boards on 14 March 2018 when I shall retire.

As we expected, 2017 saw considerable progress made towards becoming a viable business that is sustainable in the longer term and that demonstrates the values and ethics on which we were founded and continue to operate in our business today. There remains significant work to do but, with the support of shareholders, we have created the opportunity to deliver that sustainability.

Finally, on behalf of the Board, I would like to thank our outgoing Executive and Non-Executive Directors for their work and contribution during their respective terms. I am confident that we have an excellent team ready to address the many challenges of the year ahead.

Dennis Holt
Chairman
13 March 2018

Ownership
The Bank Company is a public limited company with debt securities listed on the London Stock Exchange. Its equity is not listed. It has listed covered bonds with a maturity date of 2021.

The Bank undertook the Restructuring and Recapitalisation in 2017. As at 1 September 2017, the Bank's sole shareholder is The Co-operative Bank Holdings Limited (Holding Company), which is a private company limited by share capital. The former significant shareholder, Co-operative Group Limited, reduced its residual holding in the Holding Company to 1% at the completion of the Restructuring and Recapitalisation on 1 September 2017 and has since effected a disposal of this holding.

The Holding Company's share capital is divided into Class A ordinary shares of £0.0001 each and Class B redeemable preference shares of £0.01 each. The A shares are entitled to dividends to be paid out of the profits of the Holding Company, but the B shares do not carry any right to participate in the profits of the Holding Company, except as provided for on a Bank Exit (any transaction or arrangement which results in the Holding Company ceasing to be the Bank's direct or indirect Holding Company or ceasing to hold directly or indirectly substantially all of the assets of the Bank) or IPO Exit (admission of the A shares of the Holding Company to a securities exchange, as defined in the Articles of Association of the Holding Company (Holding Company Articles)). On a return of capital on liquidation, dissolution or winding up, the surplus assets of the Holding Company are applied first, in respect of each B share, an amount equal to the nominal value (and if such proceeds are insufficient, allocated between them pro rata to the aggregate amount due to each), and second, the balance remaining (if any) shall be distributed to the A shareholders pro rata by reference to the number of A shares held by them respectively.

No A shareholder is entitled to receive notice of, nor attend to vote at a general meeting of the Holding Company, save where a resolution is to be proposed at such meeting: abrogating or varying any of the rights or privileges attached to the A shares; for the winding up or dissolution of the Holding Company; in respect of the purchase or redemption (save for the redemption of B shares) of any share capital of the Holding Company; or in respect of a Bank Exit or IPO Exit. Each and every B shareholder is entitled to receive notice of, attend and vote at a general meeting of the Holding Company, with one vote in respect of each B share registered in the name of the holder.

Member Matters (as defined in the Bank's Articles of Association (Bank Articles)) may only be taken by the Board of the Bank, with the approval of the Holding Company by ordinary resolution.

B shareholder Matters (as defined in the Holding Company Articles) may only be undertaken by the Board of the Holding Company or approved for implementation at Bank level, with the prior written approval of the holders of more than 50% of the B shares in issue.

The B shareholders are entitled to appoint up to two Directors to the Board of the Holding Company, and the Holding Company is entitled to appoint up to two Directors to the Board of the Bank, who are designated as B Directors of the Holding Company and the Bank. The B Directors are Charles Bralver and Tom Wood.

On 1 September 2017, the Holding Company and the B shareholders (as set out in Schedule 1 to the B shareholders Agreement, and any person who executes a Deed of Adherence in the form set out in Schedule 2 to the shareholders Agreement) entered into a B shareholders Agreement for the purpose of setting out the Exit Premium principles in accordance with the Holding Company Articles. Subject to other provisions of Holding Company Article 12, if at any time an A shareholder (together with its affiliates):

- is the registered holder of equal to or greater than, 10% of the A shares then in issue (the B Threshold);
- has been and is approved by the PRA as a Controller of the Company; and
- executes a deed of adherence to the B shareholders' Agreement, together the 'Qualifying Conditions',

such A shareholder shall be deemed a 'Qualifying Shareholder' and the Holding Company shall have the power to allot and issue to them, one B share for every 1% held of the A shares then in issue (rounded down to the nearest whole percentage point).

As at 13 March 2018, the B shareholders of the Holding Company were: SP Coop Investment, Ltd (25.33%); Goldentree Asset Management Lux S.A.R.L. (18.68%); Cyrus Opportunities Master Fund II Ltd (16.00%); Invesco Asset Management Limited for and on behalf of its discretionary managed clients via The Bank of New York Nominees Limited (13.33%); Anchorage Illiquid Opportunities Offshore Master V.L.P (13.33%); and Blue Mountain Cayman SP for and on behalf of Balloon SP (13.33%).

Compliance with the UK Corporate Governance Code
The UK Corporate Governance Code, published by the Financial Reporting Council in 2016 (the Code), sets out standards of good practice in relation to Board leadership and effectiveness, remuneration, accountability and relations with shareholders. As part of the Restructuring and Recapitalisation the previous requirement to use reasonable endeavours to comply with the Code was removed but the Directors will continue to support high standards of Corporate Governance, paying attention to the proposed revisions to the Code as outlined in the Financial Reporting Council's consultation paper of December 2017.

Values and Ethics
Under the Holding Company's and Bank Company's Articles of Association, there is a requirement on the Holding Company and Bank Company to promote and conduct its business to the extent practicable in a manner informed by the established values of the co-operative movement, in particular with regard to:

- how it relates to, communicates with, balances the interests of, and otherwise deals with its stakeholders; and
- how it applies the profits of the Bank, in accordance with the dividend policy set out in its Articles of Association.

Role and Responsibilities of the Board of the Bank Company and the Board of the Holding Company
The Boards have collective responsibility for the long term success of the Holding Company and Bank Company. Their role is to provide leadership within a framework of prudent and effective controls which enable risk to be assessed and managed. They set the values and standards and ensure that their obligations to shareholders, customers and other stakeholders are understood and met.

The Board of the Bank Company sets the Bank's strategy and approves plans presented by management for the achievement of the strategic objectives it has set. It determines the nature and extent of the principal risks it is willing to take in achieving its strategic objectives and is responsible for ensuring maintenance of sound risk management and internal control systems.

The Board and shareholders have approved a schedule of Matters Reserved for the Board and authorities delegated to the Chief Executive Officer (CEO). Both the Matters Reserved for the Board and the CEO's delegated authorities have been revisited by the Board and re-adopted for 2018 with appropriate adjustments.

Implementation of the strategy set by the Board of the Bank Company and the management and day-to-day running of the Bank is delegated to the CEO, with oversight by the Board, with the exception of the Matters Reserved for the Board.

The Board
As reported in the Chairman's introduction to this report, there have been changes to the Board of the Bank Company during 2017 and the Board of the Holding Company.

Composition
Details of the members of the Boards, their biographies and details of length of service are set out on page 30.

Bob Dench joined the Board as a Non-Executive Director on 1 February 2018 and will become Chairman of both Boards on 14 March 2018 succeeding Dennis Holt, who has been Chairman of the Bank since October 2014, and is retiring.

Bob Dench has enjoyed a long career in banking, and has been Chair of Paragon Banking Group Plc since 2007, having joined its Board in 2004. He chaired Paragon through the financial crisis and oversaw a configuring of the business model as Paragon obtained its banking licence. He will remain in his role at Paragon until a successor has been appointed.

All the Non-Executive Directors have considerable experience and make valuable contributions to the Bank. The Non-Executive Directors constructively challenge and help develop proposals on strategy and bring strong, independent judgement, knowledge and experience to the Board's deliberations.

The Non-Executive Directors are of sufficient calibre and number such that their views carry significant weight in the Boards' decision making.

Holding Company Board changes
During 2017, 10 Directors were appointed to the Board and one Director stood down. An additional Director was appointed to the Board on 1 February 2018.

Current members of the Board		Independent	Appointed
Dennis Holt	Chairman	On appointment to the Board of the Bank	1 September 2017
Aidan Birkett	Senior Independent Director	Independent	1 September 2017
William Thomas	Non-Executive Director	Independent	1 September 2017
Laura Carstensen	Non-Executive Director	Independent	1 September 2017
Derek Weir	Non-Executive Director	Independent	1 September 2017
Charles Bralver	Non-Executive Director	Not Independent	1 September 2017
Glyn Smith	Non-Executive Director	Independent	1 September 2017
Bob Dench	Non-Executive Director	Independent	1 February 2018
Liam Coleman	Chief Executive Officer	N/A	13 July 2017
Tom Wood	Chief Financial and Restructuring Officer	N/A	13 July 2017

Members of the Board stepping down since 1 January 2017		Independent	Appointed	Ceased to be a Director
John Worth	Chief Financial Officer	N/A	1 September 2017	20 September 2017

Bank Company Board changes

During 2017 one Director was appointed to the Board and three Directors stood down. An additional Director was appointed to the Board on 1 February 2018.

Current members of the Board		Independent	Appointed
Dennis Holt	Chairman	On appointment	3 February 2014
Aidan Birkett	Senior Independent Director	Independent	1 July 2015
William Thomas	Non-Executive Director	Independent	28 October 2013
Laura Carstensen	Non-Executive Director	Independent	27 May 2014
Derek Weir	Non-Executive Director	Independent	25 July 2014
Charles Bralver	Non-Executive Director	Not Independent	23 April 2015
Glyn Smith	Non-Executive Director	Independent	10 October 2016
Bob Dench	Non-Executive Director	Independent	1 February 2018
Liam Coleman	Chief Executive Officer	N/A	11 July 2016
Tom Wood	Chief Financial and Restructuring Officer	N/A	1 September 2017

Members of the Bank Board stepping down since 1 January 2017		Independent	Appointed	Ceased to be a Director
Maureen Laurie	Non-Executive Director	Independent	30 June 2014	1 September 2017
Alistair Asher	Non-Executive Director	Not Independent	12 September 2016	1 September 2017
John Worth	Chief Financial Officer	N/A	11 October 2016	20 September 2017

Appointment and Reappointment of Directors

All Non-Executive Directors are appointed to the Boards for an initial term of three years but, under the terms of their appointment, are required to submit themselves for annual re-election at the Holding Company's and Bank Company's Annual General Meetings (AGMs). All Directors will offer themselves for election or re-election at the AGMs in 2018 except for Dennis Holt and Aidan Birkett, who will both step down on 14 March 2018. The terms of appointment of the Non-Executive Directors are available for inspection on request to the Secretary.

The biographical details of all Directors are discussed on pages 30 to 31 and can also be found on our website at: www.co-operativebank.co.uk/aboutus/governance/Directors

Attendance

The following table sets out the attendance at scheduled Holding Company Board meetings:

Name	Date of Appointment	Date ceased to be a Director	Board Meetings attended[1]
Liam Coleman	13 July 2017		11 (11)
Tom Wood	13 July 2017		10 (11)
Dennis Holt	1 September 2017		6 (6)
Aidan Birkett	1 September 2017		4 (6)
Laura Carstensen	1 September 2017		3 (6)
Derek Weir	1 September 2017		6 (6)
Glyn Smith	1 September 2017		6 (6)
William Thomas	1 September 2017		4 (6)
Charles Bralver	1 September 2017		6 (6)
John Worth	1 September 2017	20 September 2017	0 (1)

This includes business as usual scheduled meetings following the Restructuring and Recapitalisation and also additional meetings connected with the Restructuring and Recapitalisation.

The following table sets out the attendance at scheduled Bank Board meetings:

Name	Board Meetings attended[1] (entitled to attend)[2]	Audit Committee attended[1] (entitled to attend)[2]	Risk Committee attended[1] (entitled to attend)[2]	Value and Ethics Committee attended [1] (entitled to attend)[2]	Remuneration Committee attended [1] (entitled to attend)[2]	Nomination Committee attended[1] (entitled to attend)[2]
Dennis Holt	11 (11)	2 (2)		1 (1)	8 (8)	5 (5)
William Thomas	10 (11)	8 (10)	6 (8)	3 (3)	2 (2)	2 (2)
Laura Carstensen	9 (11)		7 (8)	4 (4)	7 (9)	
Maureen Laurie	7 (7)			2 (2)	7 (7)	3 (3)
Derek Weir	11 (11)	10 (12)	8 (8)		2 (2)	
Charles Bralver	10 (11)		7 (8)	1 (1)	2 (2)	2 (2)
Aidan Birkett	9 (11)	9 (12)			8 (9)	4 (5)
Alistair Asher	7 (7)			2 (2)		
Liam Coleman	11 (11)			2 (2)		
Glyn Smith	11 (11)	12 (12)	8 (8)	1 (1)		
John Worth	7 (7)					
Tom Wood	4 (4)					

1. Business as usual scheduled meetings.
2. The Director concerned was entitled to attend because he/she was a member of the Board or Committee at the time of the meeting.

Number of Bank Board and Committee meetings in 2017

Board meetings (scheduled):	11
Audit Committee meetings:	12
Risk Committee meetings:	8
Remuneration Committee meetings:	9
Values and Ethics Committee meetings:	4
Nomination Committee meetings:	5

Where Directors are unable to attend Board meetings, usually for reasons of illness or a requirement to hold these at shorter notice than is usual, the Chairman encourages Directors to provide their views, questions and comments directly to him.

In addition to the above scheduled Board meetings there were 45 ad hoc meetings to support the Restructuring and Recapitalisation, strategic and other ad hoc matters and one Pension Sub-Committee meeting.

During 2017, all Directors exceeded the time commitment set out in their letter of appointment.

Information to Directors

Directors and usual attendees of Board and Committee meetings use a Board portal and an electronic tablet as their primary method for the receipt of papers. The electronic tablet provides access to additional materials to support Directors in their preparations for Board and corporate activity including constitutional documents and the materials from previous meetings.

In the ordinary course of scheduled Board and Board Committee meetings the aim is to provide the Directors with access to Board and Committee papers seven days before a meeting.

Board Committees

The Boards have established Board Committees, namely; the Audit Committees, the Risk Committees, the Values and Ethics Committees, the Nomination Committees and the Remuneration Committees.

All Board Committees have Terms of Reference describing the authority delegated to it by each Board. Each of these Committees has a role in ensuring the effective oversight by the Boards, of the Group, Bank and its subsidiaries.

The Terms of Reference for the Bank Audit Committee, Risk Committee, Values and Ethics Committee, Nomination Committee and Remuneration Committee of the Bank can be found at:
www.co-operativebank.co.uk/aboutus/governance/terms-of-reference-for-Board-Committees

Secretariat maintains the Holding Company's Terms of Reference. They are not published on a website but are available to relevant stakeholders.

The Boards receive the minutes of all Committee meetings. During the year each of the Committees of the Bank reviewed its Terms of Reference and aligned them with the newly created Terms of Reference of the Committees of the Holding Company Board.

Information on the Committees of the Bank can be found on the following pages:

AUDIT COMMITTEE REPORT

Introduction by Audit Committee Chairman

The Audit Committee continues to provide oversight and informed challenge over the systems of financial reporting and control, accounts preparation and internal and external audit processes. Areas of particular focus have been the preparatory work for the implementation of IFRS 9, improvements to the systems of financial reporting and control, and the accounting implications of the Restructuring and Recapitalisation. Through the work of Internal Audit, the Committee has provided oversight of the embedding of the Risk Management Framework (RMF). It also oversees the Concern at Work (Whistleblowing) arrangements.

Glyn Smith
Audit Committee Chairman
13 March 2018

Purpose of the Audit Committee

To monitor, review and report to the Board and its sole shareholder on the formal arrangements established by the Board in respect of the financial and narrative reporting of the Bank, the internal controls and the RMF, the internal audit and the external audit processes.

Audit Committee membership	Date of appointment	Date of resignation
Glyn Smith (Chairman)	Appointed 10 October 2016 Chairman since 26 October 2016	
Derek Weir	Appointed 9 December 2014	
Aidan Birkett	Appointed 23 September 2015	
William Thomas	Appointed 1 July 2016	Resigned 26 September 2017
Dennis Holt	Appointed 26 September 2017	

Glyn Smith retained the Chairmanship of the Committee throughout the year. William Thomas stepped down from the Committee on 26 September 2017 and the Chairman of the Board joined the Committee with effect from the same date. Meetings of the Committee are generally attended by the Chief Financial and Restructuring Officer, Chief Executive Officer, invited members of the Finance and Risk teams and the Director of Internal Audit, none of whom attends as of right. The external auditor attends Committee meetings, and private meetings are held with internal and external auditors and with the risk function as necessary to afford them the opportunity of discussions without the presence of management. The Committee met 12 times during the financial year. The Chairman of the Committee reports back to the Board on the outcomes of meetings and the Board receives the minutes of all Committee meetings.

Alignment with Risk Committee

The Committee recognises the common interest in issues relevant to both Committees. To support the co-ordination of information between the Committees, the Chairman of each of the Audit and Risk Committees is a member of both Committees. Both the Audit Committee and Risk Committee welcome attendance by representatives of the Internal Audit function and the external auditor at their meetings.

Principal responsibilities and key areas of discussion of the Committee on behalf of the Bank

Principal responsibilities of the Audit Committee	Key areas discussed and reviewed by the Committee in 2017
Financial and narrative reporting	
• Review the content of the Annual Report and Accounts and advise the Board on whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the performance, business model and strategy; • Monitor the integrity of the financial statements; and • Review and challenge where necessary: • the consistency of, and any changes to, significant accounting policies both on a year on year basis and across the financial statements; • the methods used to account for significant or unusual transactions where different approaches are possible; • whether appropriate accounting standards have been followed and appropriate estimates and judgements made, taking into account the views of the external auditor; • the assumptions or qualifications in support of the going concern statement; • the clarity and completeness of disclosure in the Bank's financial reports and the context in which statements are made.	• The Committee allocates a number of meetings in its calendar to focus on the preparation for and review of the Interim Accounts and the Annual Report and Accounts. During 2017 the review process included a detailed review of significant accounting judgements and accounting policies and regular dialogue with Ernst & Young LLP. The Accounting Policy Forum reviews all accounting policies for significant transactions and the Key Judgements Forum reviews, challenges and approves all key judgements and associated journal postings. The Committee received regular updates relating to decisions made at the Key Judgements Forum. The Committee also considers the Annual Report and Accounts and Interim Accounts process to assess the impact on financial reporting risk; • Key judgements discussed as part of the 2017 accounts process are detailed on page 132, including reports by the external auditor throughout the year; • The Board receives a report from the Audit Committee prior to the Board meetings which considers the content of Interim or Annual Reports. Compliance with accounting standards and the completeness of disclosures are also discussed; • The Committee received regular updates on the implementation of International Financial Reporting Standard 9 and considered its impact on the Annual Report; and • The Committee discussed the first quarterly financial report as at 30 September 2017 following the Restructuring and Recapitalisation in November 2017 and recommended it to the Board for onward circulation to the sole shareholder.
Internal controls and risk management systems	
• Review the adequacy and effectiveness of internal financial controls and internal control and risk management systems and statements in the Annual Report concerning internal controls and risk management.	• During 2017, the Audit Committee considered the recommendations of Internal Audit and the external auditor in respect of internal control mechanisms and monitored progress against those recommendations. Both the Director of Internal Audit and the Chief Risk Officer attended Audit Committee meetings throughout the year; and • During 2017, the Committee considered the report on Risk Management, Internal Control and related Financial and Business Reporting in relation to the Bank's Risk Management Framework for the 2016 Annual Report and Accounts. The Committee has reviewed similar disclosure for the 2017 Annual Report and Accounts.

Principal responsibilities of the Audit Committee	Key areas discussed and reviewed by the Committee in 2017
Internal audit	
• Approve the appointment or termination of appointment of the Director of Internal Audit; • Review and approve the Charter of the Internal Audit function and ensure the function has the necessary resources and access to information to enable it to fulfil its mandate, has unrestricted scope and is equipped to perform in accordance with appropriate professional standards for internal auditors; • Ensure the Director of Internal Audit has direct access to the Chairman of the Board and to the Chairman of the Committee, and is accountable to the Committee, ensuring that Internal Audit is independent of the Executive and able to exercise independent judgement; • Review and assess the annual internal audit work plan and the reasons for any significant change or delay to this plan, ensuring that it includes the evaluation of the effectiveness of the risk, compliance and finance functions; • Receive reports on the results of the internal auditor's work; • Review and monitor management's responsiveness to the internal auditor's findings and recommendations; • Meet with the Director of Internal Audit at least once a year without the presence of management; and • Monitor and review the effectiveness of the Bank's Internal Audit function, in the context of the overall risk management system and consider whether an independent, third party review of Internal Audit effectiveness and processes is appropriate.	• The Committee received and considered the results of the Internal Audit annual self-effectiveness review. The review provided an update against the action plan developed following the external review carried out in 2016 by Independent Audit Limited and outlined continuous improvement work-streams under which activity was being performed to close gaps from the self-assessment and to address the remaining recommendations from the external assessment. In accordance with the Bank's Internal Audit Charter, an external assessment is conducted at least every four years; • During 2017 the Committee reviewed and challenged the Internal Audit Charter, the resources of the function and the plan of activities taking place during the year; • The Committee considers Internal Audit activity reports covering key thematic risks; • The Committee receives all 'red' rated Internal Audit reports and invites management to present findings and remedial actions; • The 2018 Internal Audit plan is due to include evaluation of the effectiveness of the risk, compliance and finance functions; and • During the year, in camera sessions were held with the Director of Internal Audit.
External audit	
• Consider and make recommendations to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, reappointment and removal of the external auditor; • Ensure that at least once every ten years the audit services contract is put out to tender and oversee the selection process; • If an auditor resigns, investigate the issues leading to this and decide whether any action is required; • Oversee the relationship with the external auditors and review the findings of the audit with the external auditor; • Approve their remuneration including fees for both audit and non-audit services; • Develop and implement policy on the supply of non-audit services by the external auditor specifying the types of non-audit service for which use of the external auditor is pre-approved and the requirement to authorise provision of any non-audit services by the external auditor to avoid any threat to auditor objectivity and independence, taking into account any relevant ethical guidance on the matter. Reporting of the use of non-audit services should include those subject to pre-approval; • Annually assess their independence and objectivity; • Review any representation letter(s) requested by the external auditor before they are signed by management; • Review the management letter and management's response to the auditor's major findings and recommendations; and • Meet regularly with the external auditor and at least once a year, without the presence of management.	• The Committee liaised closely with the external auditor in respect of their views on the most significant of the key accounting judgements and findings; • The Committee reviewed the external audit plan; • In the course of making a recommendation to the Board in respect of representations to the auditor, the Committee reviewed and challenged management assurances supporting management representation letters to the external auditors; • The Committee considered the external auditor's management letter containing observations arising from the annual and interim audits leading to recommendations for control or financial reporting improvement and monitored progress; • The Committee reviewed the draft policy for the supply of non-audit services by the external auditor in February 2017, approving the final version in March 2017; and • The Committee reviewed the independence of the external auditors and the objectivity of the audit engagement partner and audit staff using self-assessments from the external auditor and based on a review conducted by Internal Audit to review the independence and objectivity of the external auditor and review their effectiveness.
Raising a Concern at Work (Whistleblowing)	
• Review the adequacy and security of the arrangements for employees and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters and annually review and approve the Bank's Raising a Concern at Work (Whistleblowing) Policy; • Annually review the Concern at Work events report; and • Review the Committee's Terms of Reference and monitor its execution.	• The Committee received regular updates on incidents reported under the Bank's Raising a Concern at Work (Whistleblowing) Policy. In November 2017 the Committee carried out an annual review and re-approval of the Policy; and • The Committee conducted an annual review of its Terms of Reference and reviewed its deliveries against these.

Significant accounting matters

In relation to the 2017 financial statements the Committee considered the following significant accounting issues, matters and judgements. The disclosure and presentation of these matters were discussed and debated with management and the external auditors (Ernst & Young LLP).

1 Accounting matters considered by the Committee included:

1.1 Going concern

The Group has recently approved its 2018-2022 Financial Plan (the Plan) and has used this as the basis of its assessment in evaluating whether adopting the going concern basis of accounting is appropriate for the Group, Bank, Holding Company and Bank Company. This includes a detailed review of projected profitability, forecast liquidity position, capital ratios and regulatory capital considerations. Appropriate consideration has also been given to the key milestones delivered across 2017 that impact on the going concern assessment. These include the successful delivery of the Restructuring and Recapitalisation, further deleverage of the Optimum portfolio, reduction in ICG requirements and significant headroom to minimum regulatory liquidity requirements. The Plan also documents both a flightpath to profitability and to full regulatory capital compliance.

The assessment of the going concern basis of preparation has been subject to a thorough process involving analysis and discussion by management, Executive and Board Committees and the Board, in line with our governance processes.

The Committee considered and recommended to the Board that the going concern basis of accounting be adopted and the disclosures prepared by management form part of note 1.2 to the consolidated financial statements.

1.2 Impairment of loans and advances to customers

The Committee reviewed detailed papers prepared by management covering the drivers for changes to impairment provisions which include, as in previous years, the emergence period and probability of default, governance and controls over the provisions and substantive evidence supporting model parameters and appropriate post model adjustments. The Committee carefully considered evidence in the post balance sheet period as to whether additional provisions were required relative to conditions existing at the balance sheet date.

1.3 Conduct risk and legal provisioning

The Committee considered recommendations from management regarding conduct risk and legal provisioning, and considered the underlying assumptions for the population affected, size of potential redress and customer complaints received. Detailed papers were presented outlining the key judgements used and these were debated and challenged by the Committee. As well as the ongoing oversight throughout the year the Committee discussed an overview of the key assumptions and judgements made by management in determining appropriate year end conduct and legal provisions.

1.4 Accounting for the Restructuring and Recapitalisation

The Committee considered papers prepared by management which outlined the accounting for the Restructuring and Recapitalisation which took place during 2017.

1.5 Fair values of financial assets and liabilities

Management presented a paper on the basis of preparation and calculation of note 34 to the consolidated financial statements and note 24 to the Bank Company financial statements and concurred with the note disclosure.

1.6 Effective interest rate

Management presented a paper to provide an overview of how effective interest rate (EIR) accounting is applied and the impacts on the financial statements over recent years. Management also outlined how behavioural assumptions and economic assumptions impact the EIR asset.

1.7 Pensions

The Committee again debated the accounting treatment of both of the principal pension schemes, Pace and Britannia. It concluded that, as at 2017 year end, insufficient information was available to reliably account for the Pace pension scheme as a defined benefit scheme, and therefore the scheme would continue to be accounted for on a defined contribution basis, with contributions recognised as an expense in the income statement.

The Committee reviewed a paper detailing the agreement with the Britannia Pension Scheme (BPS) Trustee to change the index used to determine inflationary increases for pensions payments, from RPI to CPI, and noting this change is considered to represent a plan amendment.

1.8 Business separation

In line with previous years, the Committee considered the requirement for a separation provision and concluded that the Group has satisfied both its legal obligations to its customers and constructive obligations to restructure its IT operations from Co-operative Group and therefore no provision is required as at 31 December 2017.

1.9 Surrendered loss debtor

The Committee discussed the measurement of the surrendered loss debtor (SLD) due by Co-operative Group in relation to previous losses surrendered, and reviewed a paper prepared by management setting out the key assumptions inherent in the calculation. The key judgements associated with the calculation of the SLD include assumptions on Co-operative Group's capacity to realise the benefit of the tax losses surrendered, the accuracy of the repayment profile information provided by Co-operative Group, the extrapolation of the repayment profiles provided by Co-operative Group and future changes to tax legislation.

1.10 Accounting for Warwick Finance Three transaction
The Committee considered papers prepared by management which outlined the accounting for the Warwick Finance Three transaction which took place in October 2017.

1.11 Derecognition of financial assets
The Committee noted that derecognition of certain securitisation transactions remained valid, namely Warwick Finance One, Two and Three.

1.12 Valuation of Visa International preference shares and deferred consideration
The Committee considered the basis of valuation of Visa International preference shares and deferred consideration resulting from the sale of the shares in Visa Europe in 2016 and challenged the assumptions previously applied to determine whether these are still appropriate for the 31 December 2017 valuation.

1.13 Britannia fair value adjustments
During the merger with Britannia Building Society in 2009, the assets and liabilities of Britannia were brought onto the balance sheet at estimated fair value; the assumptions associated with the unwind of the remaining fair value adjustments were reviewed for 2017 year end. See note 34 to the consolidated financial statements for further details.

1.14 Asset impairment
The Committee reviewed an analysis prepared by management outlining the impairment of assets, particularly relating to branch properties held for sale as at 31 December 2017, and concurred with the resulting year end carrying value.

1.15 Unadjusted errors
The external auditors reported to the Committee the misstatements identified in the course of their work, including in respect of prior years; no material amounts remain unadjusted.

1.16 Fair, balanced and understandable
The Committee considered whether the Annual Report and Accounts 2017 are fair, balanced and understandable. The Committee satisfied itself that there was a robust process of review and challenge to ensure balance and consistency. This process included internal verification of the document and senior level review of the document both on an individual and committee basis prior to a meeting of the Committee held to review and consider the Annual Report and Accounts in advance of approval by the Board.

The Committee has considered the following matter in relation to future reporting periods:

1.17 IFRS 9
The Committee was regularly updated as to the implementation of IFRS 9 including a review of the approach to IFRS 9, the work underway to implement IFRS 9 and the project status. A programme of periodic IFRS 9 updates to the Committee is in place. The Committee also considered IFRS 9 disclosures in the Annual Report and Accounts 2017.

2 Governance over accounting policy and judgements
The Committee considered the governance to support financial reporting risk including the Accounting Policy Forum, which oversees accounting policy, and the Key Judgements Forum which reviews and challenges significant accounting judgements.

Performance Evaluation

External audit

The external auditor is appointed by shareholders to provide an opinion on the financial statements and certain other disclosures prepared by the Directors.

The Audit Committee is responsible for oversight of the external auditor, including reviewing the audit strategy and, on behalf of the Board, approving the audit fee. The Audit Committee has developed and implemented a policy on the supply of non-audit services by the external auditor to avoid any threat to auditor objectivity and independence, taking into consideration any relevant guidance on the matter.

Non-audit services are normally limited to assignments that are closely related to the annual audit or where the work is of such a nature that existing knowledge and understanding is necessary. Accordingly, due to the Restructuring and Recapitalisation, spend was higher in 2017. Management regularly provides the Audit Committee with reports on audit, audit-related and non-audit expenditure, together with proposals of any significant non-audit related assignments.

The Audit Committee reviews and, where necessary, challenges management to ensure auditor objectivity and independence is not impaired. Fees for audit-related non-audit services and audit expenses for the year amounted to £5.5m (2016: £3.7m). Details of the auditors' remuneration can be found in note 4 to the consolidated financial statements. The Audit Committee is satisfied that the overall levels of audit-related, non-audit fees and audit expenses are not material relative to the income of the external audit offices and firm as a whole and did not impair the objectivity and independence of the external auditor.

The Audit Committee evaluated the performance since appointment, independence and objectivity of Ernst & Young LLP (EY) and also reviewed their effectiveness as external auditor, taking into account the following factors:

- the external auditor's progress achieved against the agreed audit plan and communication of any changes to the plan, including changes in perceived audit risks, such as the implementation of IFRS 9;
- the competence with which the external auditor handled the key accounting and audit judgements and communication of the same with management and the Audit Committee;
- the external auditor's compliance with relevant regulatory, ethical and professional guidance on the rotation of partners;
- the external auditor's qualifications, expertise and resources and their own assessment of their internal quality procedures; and
- the stability that would be provided by continuing to use EY.

During 2017, the external auditor provided the Audit Committee with a management letter summarising its main observations and conclusions arising from the 2016 year end audit, half year reviews and any recommendations for enhancements to reporting and controls. Mitigating actions were identified for implementation. Internal Audit have been monitoring and tracking the implementation of these actions, with regular reporting to the Audit Committee on progress made.

Internal controls

Where material risks have been identified, action has been instigated to strengthen systems of internal control to mitigate these risks. The Board is ultimately responsible for the system of internal controls and it discharges its duties in this area by ensuring management implements effective systems of risk identification, assessment and mitigation. These risk management systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives and cannot provide absolute assurance against material misstatement or loss.

Management is responsible for establishing and maintaining adequate internal controls over financial reporting, including the consolidation process. Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes. A strategic planning, budgeting and forecasting process is in place. Monthly financial information is reported to the Board and management. The Executive Committee (ExCo) reviews performance against budget and forecast on a monthly basis and senior financial managers regularly carry out an analysis of material variances.

Responsibility for reviewing the effectiveness of the internal controls has been delegated to the Audit Committee by the Board.

The Audit Committee uses information drawn from a number of different sources to carry out this review:

- Internal Audit provides objective assurance – their annual work plan is developed in conjunction with management and approved by the Audit Committee focusing on key risks and key internal controls. In the light of Internal Audit's recommendations, management develops and implements corrective action plans, which are tracked to completion by Internal Audit, with the results reported to Executive Management and to the Audit Committee;
- the Risk Management Framework for reporting and escalation of control issues; and
- further objective assurance is provided by external specialists.

Internal Audit
The Bank has an Internal Audit department comprising 19 in-house auditors supported by Internal Audit co-source arrangements with Deloitte LLP, PwC LLP, KPMG LLP, Grant Thornton UK LLP and Protiviti Limited. The co-source arrangements, which have been in place for a number of years, support the Bank's requirements for specialist skills or additional resources where it would be inefficient to resource internally. The Internal Audit team comprises staff with a mix of professional skills and qualifications, including qualified accountants and auditors with recent financial experience. Independence of the internal audit function is supported by the Internal Audit Director reporting directly to the Chairman of the Audit Committee and administratively to the CEO.

To provide coverage of risks, Internal Audit has an audit universe which provides an holistic view of audit coverage at a business entity and process level. This is supplemented by an assessment of inherent risks and control environment, aligned to the Risk Management Framework. The audit plan is aligned to the Financial Plan and also covers mandatory requirements from relevant regulators.

The Internal Audit plan is based upon a quarterly planning cycle which continues to give flexibility on the type of assurance provided and aligns to the developing risk profile. The audit plan is approved by the Audit Committee, and shared with the regulator.

During 2017, the scheduled internal audit reporting activity addressed a cross section of key operations and internal control mechanisms. A total of 44 internal audit reports were delivered for the 2017 Internal Audit plan (2016: 38), which enabled the Audit Committee to assess the control environment overall and make recommendations for areas of focus to the Risk Committee and to the Board.

The Audit Committee is responsible for evaluating the performance of the Internal Audit function on a regular basis to ensure that the function complies with the Chartered Institute of Internal Auditors (CIIA) International Standards. In doing so, it has identified appropriate criteria for defining the success of Internal Audit and, in-line with the CIIA International Standards, delivery of the audit plan is not the sole criterion for this evaluation.

The last independent external quality assessment (EQA) was conducted in Q1 2016. There were no high priority issues raised, and all suggested areas for improvement have been actioned.

Internal audit reports are issued to Executive Management and a summary of reports issued are reported to the Audit Committee on a quarterly basis. High and medium-rated audit issues and the related management actions are tracked to completion by Internal Audit. Where audit issues are overdue, these are reported to Executive Management, Enterprise Risk Oversight Committee (EROC) and the Audit Committee. All management actions are recorded on a bank-wide risk management application and database to facilitate tracking and reporting. Monthly reports are produced on action status updates, which are shared with the business, Executive Management and other Board Committees.
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VALUES AND ETHICS COMMITTEE REPORT

I am pleased to present the report of the Values and Ethics Committee (V&E Committee) and my third as its Chair. 2017 marked the 25th anniversary of our customer-led Ethical Policy. The Committee focused on further embedding ethical processes into operational processes following an internal audit review of procedures in 2016 ensuring that the mechanisms around screening our business and SME customers continue to be robust.

The Co-operative Bank has a strong heritage in the North West of England and we are committed to our Manchester base. One of the most significant news events of 2017 was the attack on Manchester Arena, which is located in close proximity to our head office. I was extremely proud of the role the Bank and our colleagues and customers played in the community response to the tragic events, with an immediate fundraising effort towards the British Red Cross UK Solidarity Fund, and the facilitation of donations through our branches and customer contact centres.

The Committee oversaw the initiation of a new charity partnership with youth homelessness charity, Centrepoint following the expansion of their operations into Manchester in early 2017. Through our fundraising through customers and colleagues, we have been able to raise over £450,000 for Centrepoint, enabling the charity to establish a new support hub in Manchester and launch a new UK telephone helpline for young people at risk of being made homeless.

Our support for the Co-operative sector continued through our sponsorship of The Hive, a business support programme for people wanting to start new or grow existing co-operatives or community enterprises. The Hive is a joint initiative between the Bank and Co-operatives UK. I am delighted that the partnership has been able to help over 350 co-operatives and other groups, with some great examples of how the co-operative ownership model can generate growth, jobs and community engagement across a range of sectors.

I was pleased to see our 2015/16 ‘My Money, My Life’ campaign with the domestic violence charity Refuge bear results with our involvement with our trade body, UK Finance. We have chaired the Financial Abuse Project Group and we continue to press for the formulation of a new code of practice for the banking industry which is being finalised.

In 2016, we were proud to be one of the first signatories to the Government’s ‘Women in Finance’ Charter, setting a target of 40% of women in senior roles by 2020. The Committee continued to monitor progress towards that target during 2017 and we reported on our position in 2017, alongside our Gender Pay Gap reporting.

I have witnessed first-hand the innovative work that has been done towards helping our most vulnerable customers who find themselves in financial difficulty, through our ground-breaking pilot scheme with Citizens Advice Manchester. The relationship means dedicated resource at Citizens Advice is committed to helping our customers with their whole financial situation, not just the debts they may hold with us, to get them back to financial health. Since this project started, almost 750 customers have benefited, with Citizens Advice Manchester being able to resolve 1,776 problems.

The Bank has achieved much in 2017, and in particular has developed new and existing partnerships which have provided valuable support to communities throughout the UK. I look forward to building on this work in the coming year.

Laura Carstensen
Values and Ethics Committee Chair
13 March 2018

Purpose of the Values and Ethics Committee
To recommend to the Board, for its approval and adoption, the Values and Ethical policies, and to advise the Board of conformity to such values and ethics in our operations and activities.

V&E Committee membership	Date of appointment	Date of resignation
Laura Carstensen (Chair)	Appointed 27 May 2014	
Dennis Holt	Appointed 26 September 2017	
William Thomas	Appointed 13 December 2013	Resigned 26 September 2017
Maureen Laurie	Appointed 30 June 2014	Resigned 1 September 2017
Liam Coleman	Appointed 1 July 2015	Resigned 26 September 2017
Alistair Asher	Appointed 12 September 2016	Resigned 1 September 2017
Glyn Smith	Appointed 26 September 2017	
Charles Bralver	Appointed 26 September 2017	

The Values and Ethics Committee was constituted on 1 November 2013, demonstrating the Bank’s commitment to promoting and conducting its business in accordance with its established values and ethics. Laura Carstensen was appointed as Chair of the V&E Committee on 27 May 2014. The Chief Executive Officer regularly attends the V&E Committee.

Our customers have always expected the Bank to have clear values, since we were initially established, and in 1992 we became the first bank to have a customer-led Ethical Policy. In 2017 we marked the 25th anniversary of the Policy which remains unique in UK banking because it is shaped by our customers and embodies the values of the co-operative movement. The Ethical Policy is published on the Bank's website at: www.co-operativebank.co.uk/aboutus/ourbusiness/ethicalpolicy

The Values and Ethics Committee oversaw the creation of a new charity partnership with the youth homelessness charity, Centrepoint, which saw the Bank raise money through colleague fundraising, donations linked to our current account and mortgage products, and colleague volunteering activities. The partnership and fundraising efforts have helped the charity launch its first ever UK-wide telephone helpline to help young people at risk, and we also helped provide funding towards a new resource centre in Manchester City Centre to provide services to homeless young people in our home city.

The Committee has also overseen charity fundraising through our Everyday Rewards scheme for eligible current account customers. Overall, our customers have donated £175,000 to our five charity partners. The Bank also donated an additional £35,000 to another 30 local and national charities and £45,000 to local, national and international campaigns in response to UK terrorist attacks and disaster relief responses.

In 2016, the Committee reviewed the findings of an internal audit review into the practical operation of the Ethical Policy. The Audit Committee reviewed the approach of screening business customers and suppliers against the Ethical Policy. As a result of these findings, improvements were made in 2017 to strengthen the screening process for both new and existing non-personal customers in order ensure the Ethical Policy remains robust.

During 2017, the Committee also focussed on culture in relation to being an ethical workplace, and in particular our commitments to be a Living Wage employer, gender pay reporting and our commitments to HM Treasury's Women in Finance charter. In November, the Committee approved the publication of our Gender Pay Gap and Women in Finance report which can be found at http://www.co-operativebank.co.uk/assets/pdf/bank/aboutus/ourbusiness/promoting-equality-in-the-co-operative-bank.pdf

The Committee's Terms of Reference require it to meet twice during the year; however, the Committee met more frequently in 2017 than required by its Terms of Reference. This was particularly important as it focused on a review of performance against the five pillars of the Ethical Policy, namely: ethical banking, ethical products and services, ethical business, ethical workplace and culture and ethical campaigning. This is summarised in an annual report for approval by the Board. The Committee met four times during 2017 and has agreed to meet four times during 2018 to ensure that more substantive items are reviewed together.

The Chair of the Committee, together with each of the Chairs of the Remuneration and Risk Committees, engaged on a regular basis to ensure that there was consideration of values and ethics in the discussion and reporting of issues at Board and Committee meetings, including matters such as product reviews, policies and Executive remuneration structures.

The Committee Chair, together with other members of the Committee will attend the Annual General Meeting to answer any shareholder questions on the Committee's activities.

Principal responsibilities and key areas of discussion of the Committee on behalf of the Bank

Principal responsibilities of the Values and Ethics Committee	Key areas discussed and reviewed by the Committee in 2017
Values and ethical policies • Recommend to the Board for approval and adoption the values and ethical policies. • Represent, monitor and advise the Board on matters concerning the interests of customers, suppliers, employees and other stakeholders in their dealings with the Bank in line with the Articles of Association having regard to: (i) the legal and regulatory requirements applicable; (ii) the need to be commercially sustainable and profitable; and (iii) the desirability of maintaining and enhancing image and public reputation.	• The Committee oversaw the continued adherence to the Bank's Ethical Policy - the latest version of which was launched in January 2015. • The Committee reviewed and approved the Bank's annual values and ethics Report which features the key steps taken to bring the Ethical Policy to life and embed ethics in to how we do business. The report can be seen here: http://www.cooperativebank.co.uk/assets/pdf/bank/news/values-and-ethics-report-2016.pdf. • The Committee considered the potential impact of the sale or Restructuring and Recapitalisation in relation to its values and ethics and continued compliance with legal and regulatory requirements. • Consideration of matters by the Board regularly draws upon the views and advice of the Committee in respect of the interests of stakeholders and values and ethics.
Monitoring and reporting values and ethics related activities and alignment to the Bank's Ethical Policy • Customer satisfaction levels (with a focus on service levels and on the product offering in the light of the values and ethics policies, in each case assessed by reference to relevant customer metrics). • Alignment of treatment of customers with our values and ethics. • Alignment of employee training and culture with values and ethical policies. • Corporate social responsibility, community investment, environmental and other projects and activities. • The approach to improving the social and environmental impacts of our own operations. • Establishment of a clear ethical policy and ethical strategy informed by customer consultation that aligns with the commercial strategy and is reviewed annually. • The extent to which Executive remuneration policies are consistent with the values and ethical policies • Provision of products and services to sectors/organisations with clear social justice or community benefit purpose. • The development of products and services with ethical features. • The choice of suppliers, partners and third party relationships which should be informed by the Bank's Ethical Policy. • Allocation of resource and budget to the V&E function. • Ethical campaigning activities and adherence to any commitments made under Pillar 5.	• The Committee monitored complaints resolution and the level of improvement in customer satisfaction and receives regular updates from the Customer Service and Customer Insight teams. • The Committee receives updates as required on the Vulnerable Customers work and reviews the work in relation to Vulnerable Customers at least annually. • The Committee was updated on the embedding of the values and ethics framework. • The Committee considered the allocation of 'Customers who Care' provision and considered the campaigning priorities for 2017 which resulted in the partnership with Centrepoint. The Committee also continued to support the colleague volunteering scheme and has been monitoring the uptake amongst colleagues which increased over 2017. • The Committee considered and evaluated the impact of a number of programmes on values and ethics. The Committee also supported the commitment to an ethical workplace including monitoring its commitment to the Living Wage, the Gender Pay Gap and the adoption of the HM Treasury's Women in Finance Charter. • The Committee utilised the values and ethics scorecard to track performance against values and ethics related metrics. • The Committee confirmed that remuneration policies remained a matter for the Remuneration Committee, but that they would continue to consider the impact on values and ethics. • The Committee monitored and contributed to the marking of the 25th Anniversary of the customer-led Ethical Policy. The Committee considered the content and wording of the Ethical Policy to ensure it remained current and appropriate.
Statement to Co-operatives UK • Monitor compliance with the statement to Co-operatives UK; and • Report on this at least annually to the Board.	• Regular meetings continue between management and Co-operatives UK to monitor compliance with the statement • The Committee monitored progress against the commitment to the three year partnership with Co-operatives UK – The Hive, a business support programme to promote social and economic development and enterprise in accordance with co-operative values. • The Committee also hosted the Secretary General of Co-operatives UK at the fourth meeting of 2017.

RISK COMMITTEE REPORT

Introduction by Risk Committee Chairman
'The Committee has continued to review and challenge the work undertaken to identify, mitigate and report risks through its Risk Management Framework (RMF). The Committee has continued to focus on the strengthening of the Risk function, the ongoing process of de-risking and completing resolution of historic issues, including the remediation of conduct breaches. Significant progress has been made in the above and a number of other areas including the completeness, relevance and effectiveness of the reporting and management information (including credit management information) considered by the Committee, controls over financial crime (including anti-money laundering), the control framework relating to conduct and product risk and the management and governance of model risk. The overall risk culture of the organisation has radically improved, although we continue to monitor any risks which could affect our ability to implement the 2018–2022 Financial Plan.'

Derek Weir
Risk Committee Chairman
13 March 2018

Purpose of the Risk Committee
As noted in the preface to the Corporate Governance section, this is the report of the Risk Committee of the Bank, whose purpose is to review the Bank's risk appetite and report its conclusions to the Board for approval, and oversee the implementation of the Bank's RMF, taking a forward-looking perspective and anticipating changes in business conditions.

The purpose of the Risk Committee of the Board of the Holding Company is to review and challenge the Bank's risk appetite and RMF, and approve the Holding Company's risk appetite and risk policy which shall be aligned to the RMF.

Risk Committee membership	Date of appointment	Date of resignation
Derek Weir (Chairman)	Appointed 30 September 2014 Chairman since 26 January 2016	
William Thomas	Appointed 1 January 2014	
Charles Bralver	Appointed 23 April 2015	
Laura Carstensen	Appointed 1 July 2016	
Glyn Smith	Appointed 10 October 2016	

The Risk Committee met in total 12 times during the financial year; eight times for regularly scheduled meetings and four additional meetings to specifically consider the ICAAP. In performing its duties, the Committee has access to the services of the Chief Risk Officer, the Chief Executive Officer, the Chief Financial Officer, the Director of Internal Audit and the General Counsel, as well as external professional advisors. To support the interplay between the role of the Risk Committee and the Audit Committee, the Chairman of the Audit Committee is a member of the Risk Committee and the Chairman of the Risk Committee is a member of the Audit Committee. A member of the Remuneration Committee, Laura Carstensen, is a member of the Risk Committee, and Derek Weir was appointed as a member of the Remuneration Committee on 26 September 2017. This provides the cross over between the work of the Remuneration and Risk Committees and ensures that qualitative and quantitative advice is provided to the Remuneration Committee on risk weightings to be applied to performance objectives incorporated in executive remuneration.

During 2017 the Risk Management Framework has been, and continues to be, embedded in the organisation. The Committee has worked closely with the Audit Committee to monitor risk management and internal controls.

Principal risks and the level of acceptable risks are determined as stipulated in the Risk Appetite statements, aiming to ensure that there is an adequate system of risk management and that the levels of capital and liquidity held are consistent with the risk profile of the business. Exposure to credit and other risk types such as market, liquidity, operational, pension, reputational and other risks that are inherent in our industry such as strategy, product range and geographical coverage, and the processes for managing those risks, are described in detail on pages 72 to 75. The principal risks and uncertainties faced are described in the risk management section on pages 70 to 76.

Principal responsibilities and key areas of discussion of the Committee on behalf of the Bank

Principal responsibilities of the Risk Committee	Key areas discussed and reviewed by the Committee in 2017
Risk Management Framework (RMF) • Review and challenge the design, implementation and effectiveness of the RMF and make recommendations to the Board for approval. • At least annually, review and approve all new policies and those which have changed materially, supporting the RMF. • Ensure the remit of the risk management function has: - adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards; and - adequate independence, being free from management or other restrictions. • Review the capability to identify, assess, and manage new risk types.	• During 2017, the Committee actively discussed the embedding of the RMF and an update was provided to each meeting of the Committee. A RMF Dashboard was incorporated into the Bank Risk Report for the Committee to review and challenge from July 2017 onwards. • During 2017, the Committee reviewed and recommended the RMF Policy to the Board for approval, and reviewed all new policies and those which had changed materially, supporting the RMF Policy. • During 2017, the Committee considered a report which reviewed the resources, independence and effectiveness of the Risk and Compliance functions.
Risk Culture • Review, promote and challenge the risk culture, and seek assurance to satisfy itself that an appropriate risk culture prevails in the organisation. • Provide qualitative and quantitative advice to the Remuneration Committee on risk weightings to be applied to performance objectives incorporated in executive remuneration.	• At each meeting of the Committee, the Chief Risk Officer presents a Bank Risk Report which provides a holistic view of risks, including a summary of the key risk appetite trends. Individual detailed risk appetite returns and credit risk metrics are also presented to the Risk Committee at each meeting. • The Committee reviewed the embedding of risk into performance objectives and role profiles as part of the project to embed the RMF, which resulted in all employees having at least one risk-related objective for 2017. The Chief Risk Officer has reviewed risk weightings applying to executive remuneration structures and provided analysis to support Remuneration Committee activities in this area.
Risk appetite, limits and tolerances • Review, challenge and recommend to the Board for approval, all new risk appetite statements and at least annually, or more frequently as required, the risk appetite. • Review, challenge and approve any material changes to the risk appetite measures, tolerances and limits. • Review, challenge and exercise oversight of capital and liquidity management and advise the Board on strategy for capital and liquidity management. • Annually review, challenge and recommend to the Board for approval the ICAAP. • Annually review, challenge and recommend to the Board for approval the ILAAP. • Review, challenge and recommend to the Board for approval, submissions to competent authorities to be submitted in the Board's name.	• During 2017, the Committee has continued to work with the Chief Risk Officer to continually evolve the quality of data reporting seen at Committee and Board levels in order to assist the Committee in its oversight of the monitoring of risk appetite, of risk acceptances and of risk events. The quality of the reporting was overhauled during 2016 and the full suite of risk appetite metrics was reviewed and refreshed in April 2017 in line with the 2017-2021 Financial Plan (now 2018-2022 Financial Plan). • The Committee reviewed, challenged and recommended to the Board for approval the risk appetite during 2017, and changes to market risk and liquidity risk appetite as part of the RMF. • The Committee reviewed and challenged the utilisation of delegated lending within the boundaries of the Lending Discretion Framework during 2017, and the Committee reviewed, challenged and recommended the ICAAP and ILAAP to the Board for approval. • A regular progress update was provided on model risk to each meeting of the Committee during 2017. • Prior to recommending to the Board for approval, the Committee reviewed all material submissions to be provided to regulatory bodies.
Business Strategy • Provide detailed review and challenge of proposed business strategy giving consideration to the impact on the risk profile and make recommendations to the Board. • Ensure an appropriate due diligence is carried out focusing on risk aspects and implications for risk profile and appetite when advising the Board on strategic acquisitions or disposals.	• The Committee, throughout 2017, discussed and monitored the principal risks and uncertainties faced. • The Risk function reviewed the 2018-2022 Financial Plan and reported its findings to the Board in December 2017.
Risk Monitoring • Consider, oversee and advise the Board on, and provide challenge on the Bank's exposure to, all principal risks to the business, and dedicate clear and explicit focus to current and forward-looking aspects of risk exposure, especially where those risks could undermine strategy, reputation or long term viability. • Review and challenge management's risk mitigation and control remediation actions. • In co-operation with the Audit Committee, monitor identified control failings and weaknesses that raise systemic risk issues and management actions taken to resolve them. • Review reports on any material breaches of risk limits and the adequacy of proposed action. • Consider risks posed by the current and prospective macroeconomic and financial environment, drawing on financial stability assessments such as those published by the Bank of England, the Prudential Regulation Authority, the Financial Conduct Authority and other authoritative sources that may be relevant for the Bank's risk policies when preparing advice for the Board.	• The Committee monitors all principal risks to the business using the Bank Risk Report which provides a holistic view of risk, including significant and emerging risks and risk appetite trends. • During 2017, the Committee reviewed reports on potential breaches of risk appetite and proposed actions to resolve them. • The Committee considered key corporate exposures in terms of consolidated exposures and large exposure positions and risk mitigation. • The Committee has received regular reporting to help it review IT risk and the remediation programme. • The Committee has considered reporting of emerging risks during the year together with regulatory feedback given to the Bank by the Prudential Regulation Authority and the Financial Conduct Authority and the plans agreed with regulators published to the market from time to time.

Principal responsibilities of the Risk Committee	Key areas discussed and reviewed by the Committee in 2017
Regulatory risks and Compliance • Review and approve the annual regulatory risk and compliance monitoring plan and the reasons for any significant changes to the plan, taking into account the regulatory risks identified from time to time. • Review, consider and challenge regular reports from the Director of Compliance and Financial Crime and keep under review the adequacy and effectiveness of the regulatory risk and compliance function. • Receive prompt notification of any material adverse reports or sanctions by any competent authority.	• The Committee has challenged the development of certain risk models to support the attestation of, and achieving compliance with, the Capital Requirements Regulation. • During 2017 the Committee reviewed, challenged and approved the 2017 Annual Conduct and Regulatory Assurance Plan. • The Chief Risk Officer and Director of Compliance and Financial Crime (prior to September 2017, the Director of Regulatory Risk) attended Risk Committee meetings during the year providing regular reporting analysis. • During 2017, the Committee considered a report which reviewed the resources, independence and effectiveness of the Risk and Compliance functions.
Bribery prevention, anti-money laundering/terrorist financing and Code of Conduct • Review and challenge the adequacy and effectiveness of the systems and procedures for the prevention of bribery and annually review and approve the Bank's Anti-Bribery and Corruption Control Standard. • Review and challenge regular reports from the Money Laundering Reporting Officer and the adequacy and effectiveness of the anti-money laundering and counter terrorist financing systems and controls. • Review and recommend to The Board for approval the Code of Conduct and the Personal Investment Dealing Policy.	• The Committee reviewed and approved the Bank's Anti-Bribery and Corruption Control Standard in January 2017. • The Committee considered reporting from the Money Laundering Reporting Officer during the year, including the Annual Money Laundering Reporting Officer's Report. • The Committee reviewed and recommended the Code of Conduct and Personal Investment Dealing Policy to the Board during the year.
Risk Reporting • Receive reports, findings and recommendations from the Enterprise Risk Oversight Committee noting significant issues. • In co-operation with the Audit Committee, review and approve the statements to be included in the Annual Report and Accounts concerning internal controls and risk management.	• Through the reporting from the Chief Risk Officer, the Committee continued to have access to the findings and recommendations of the Enterprise Risk Oversight Committee on matters referred to the Risk Committee or to the Board. • The Committee continues to work closely with the Audit Committee in determining the Company's Annual and Interim reporting.
Chief Risk Officer • Recommend to the Board the appointment and/or removal of the Chief Risk Officer. • Meet at least once a year with the Chief Risk Officer without the presence of management.	• The Committee Chairman regularly met with the Chief Risk Officer without the presence of management during the year. • Private sessions were held regularly between the Committee and the Chief Risk Officer.

NOMINATION COMMITTEE REPORT

Introduction by Nomination Committee Chairman

'During 2017 there were significant changes in the composition of the Board and the Executive Committee, and the Nomination Committee was instrumental in the implementation of these changes. The Committee also continued to focus on Board effectiveness, while succession planning remained a key constituent of the Committee's work to ensure that the Board and the business has the skills, knowledge and experience as it seeks to deliver against its strategic aims.'

Dennis Holt
Nomination Committee Chairman
13 March 2018

Purpose of the Nomination Committee

To lead the process for Board and Senior Executive appointments by comprehensively reviewing and making recommendations on the Board and Executive Committee composition, succession planning for Executive Directors, Non-Executive Directors and certain Senior Executives, identifying and nominating candidates for Board vacancies and evaluation of candidates for the Board.

Nomination Committee membership	Date of appointment	Date of resignation
Dennis Holt (Chair)	Appointed 25 February 2014	
Maureen Laurie	Appointed 30 June 2014	1 September 2017
Aidan Birkett	Appointed 27 October 2015	
William Thomas	Appointed 26 September 2017	
Charles Bralver	Appointed 26 September 2017	

During 2017 the Nomination Committee met five times and focused on new appointments and the overall strengthening of the Board to meet the needs of the business and to be responsive to the regulatory environment in which we operate.

Full regard to the benefits of diversity in all its elements, including gender diversity is given. During 2017 the Bank's embedding of the Diversity Policy has continued across the business through driving awareness and the continuation of colleague networking groups. A diversity target has been committed to for Board and senior staff roles as envisaged by the Women in Finance Charter. The Charter helps improve opportunities and progression for women to ensure that talent rises to the top in the finance sector regardless of gender and progress to deliver against agreed targets will continue to be publically reported to support transparency and accountability. The Board considers diversity, of which gender diversity is one element, to be an important part of the search mandates for new appointments to the Board.

As the Board structure develops and further appointments are considered, the Bank will continue to encourage the executive search consultancies engaged in the search process to reflect diversity in the lists of candidates nominated for the consideration of the Board.

During 2017 the number of women on the Bank's Board reduced from two to one (11%). In 2016, the Board set a target to have a minimum of three women on the Board, which still remains.

Principal responsibilities and key areas of discussion of the Committee on behalf of the Bank

Principal responsibilities of the Nomination Committee	Key areas formally discussed and reviewed by the Committee in 2017
• Regular review of the structure, size and composition of the Board. • Identify and nominate, for approval by the Board, candidates to fill Board vacancies having regard to the balance of skills, knowledge, independence, experience and diversity on the Board. • To review the independence, effectiveness and commitment of each of the Non-Executive Directors. • Formulate succession plans for Directors and Non-Executive Directors, Senior Executives and Senior Management Function role holders including the reappointment of any Non-Executive Director at the conclusion of their specified term of office taking into account the skills and expertise needed on the Board in the future and the continued ability of the organisation to compete effectively in the marketplace. • Keep under review the diversity policy, including gender, and the measure of objectives set in implementing the policy, and progress on achieving the objectives. • Make recommendation to the Board on membership of the Audit, Remuneration and Risk Committees, and any other Board Committees. • Review the results of the Board performance evaluation including the time required from Non-Executive Directors. • The election or re-election of Directors by shareholders at the Annual General Meeting. • Review the leadership needs and consider proposals in respect of these.	• Review of the structure, size and composition of the Board along with the skills, knowledge and experience of its members to ensure that Directors remain able and have sufficient time to discharge their duties and responsibilities effectively and to the high standard required. • During 2017 the Committee considered a number of nominations at both Board and Senior Executive level. Following the resignation of John Worth as Chief Financial Officer in September 2017, Tom Wood was appointed as Chief Financial Officer on 22 September 2017. • Succession planning, including identification of external and potential external candidates for senior vacancies which may arise on a crisis; short; medium or long term basis. • The Board adopted the Board Diversity Policy recommended by the Committee in February 2015. The Committee has since reviewed the Policy and will continue to monitor progress against the Policy during 2018. • During the year the Committee monitored deliveries under the external Board performance assessment action plan. • During the year and as a result of new appointments to the Board and members stepping down during the year, the Committee considered and made recommendations to the Board on committee composition across all Board Committees. • The Committee reviewed the position of Directors offering themselves for election and re-election at the 2017 AGM.

BOARD EFFECTIVENESS

Performance evaluation
Effective relationships between the Executive Directors and the Non-Executive Directors are critical to the operation of the Boards. The Board agendas will continue to balance the need to provide oversight and governance across the business and to provide challenge where appropriate.

The Bank Board and its Committees undertook an internal self-assessment of Board Committees during Q1 2017 based on a questionnaire completed by each Director. The outcomes from these various reviews were considered by the Board and its respective Committees and action was taken where appropriate. These assessments are undertaken annually. During 2017, Aidan Birkett, as the Senior Independent Director, was responsible for the performance evaluation of the Chairman.

Induction and continuing professional development
All newly appointed Directors undertake a structured induction programme which is designed to provide them with key business information about the Bank, and includes briefing sessions with members of the Executive team and a branch visit.

As part of the process an individual training needs profile is designed for each Director, which is reviewed periodically. Throughout 2017 the Board continued to hold collective training sessions which were scheduled to take place before Board meetings.

In addition to formal training sessions, the Directors, where appropriate, have one-to-one sessions with members of the Executive.

An electronic 'Reading Room' is available as a resource to enable all Directors to access, revisit and review copies of presentations and materials from formal development sessions.

The Chairman's role is to address the development needs of the Boards as a whole, with a view to developing their effectiveness. He ensures that the Directors' professional development needs are identified and that they are adequately informed about the Bank and their responsibilities as Directors.

Senior Managers Regime (SMR)
In response to the requirements for regulated firms and the individuals within those firms set out in the Senior Managers Regime that came into force in March 2016, a dedicated SMR Programme was established within the Bank to ensure that the SMR continues to be fully addressed and implemented.

All Directors have been briefed extensively and have received training in connection with the requirements set out in the Senior Managers Regime.

Conflicts of interest
Pursuant to the Companies Act 2006, the Directors have a duty to avoid situations in which they have or may have interests that conflict with those of the Bank and Holding Company unless that interest is first authorised by the other Directors. The Bank and the Holding Company's Articles of Association allow the Boards to authorise such potential conflicts and there is a procedure to deal with actual or potential conflicts. Directors are reminded, at each Board meeting, of their duty to report actual or potential conflict as soon as they become aware of any such events. All potential conflicts approved by the Boards are recorded in the Conflicts of Interest Register which is reviewed at each Board meeting to satisfy itself that all potential conflicts are appropriately considered and have been approved. The Boards have determined that a Director with a potential or actual conflict will not be permitted to form part of the quorum or vote upon the matter giving rise to the conflict. The Boards have put in place protocols to address potential conflicts arising from the appointment of the Non-Executive Director who is not independent for the purposes of the Companies Act 2006.

Prior to taking up any external appointment or responsibilities, Directors are asked to consult with the Company Secretary and the Chairman.

Directors and their interests
No Director had a material interest at any time during the year in any contract of significance, other than a service contract, with the Holding Company, Bank Company or any of its subsidiary undertakings.

No Director had a beneficial interest in any shares in the Holding Company or Bank Company.

Insurance and indemnities
During 2017 the Holding Company maintained appropriate Directors' and Officers' liability insurance on behalf of all Group entities in respect of legal action against their Directors and Officers. Various Officers had, and continue to have, the benefit of indemnities from the Bank Company in relation to losses and liabilities they may incur in their employment. In addition, qualifying third party indemnity provisions (as defined by section 234 of the Companies Act 2006) were in operation during 2017 and are in force for the benefit of the Directors in relation to certain losses and liabilities which they may incur in connection with their appointment.

Professional advice and Board support
A number of external consultants provide professional advice to the Boards from time to time. There is a procedure in place by which, with prior agreement, the Directors may take independent professional advice at the Group's expense in furtherance of their duties.

STATUTORY DISCLOSURES INFORMATION

Share capital structure, transfer restrictions and takeover bid related disclosures

Following the Restructuring and Recapitalisation of the Bank, the Bank's total issued share capital of ordinary shares of £0.05 each are all owned by the Holding Company. The Holding Company's share capital is divided into Class A ordinary shares of £0.0001 each and Class B redeemable preference shares of £0.01 each. For further information relating to ownership, please see the Corporate Governance Report on page 34.

Transfer of shares

The shareholder of the Bank Company may transfer any shares in any manner which is permitted by law and is from time to time approved by the Board of the Bank Company. The A ordinary shares in the Holding Company are freely transferrable save that they may not be transferred to a commercial competitor without the sanction of a special resolution of the Holding Company. Restrictions on the transfer of the B redeemable preference shares can be found within the Holding Company's Articles of Association and further details are shown in the Corporate Governance Report on page 34.

PRA approval is required if a person intends to acquire or increase its 'control' of a UK authorised person (which includes the Bank). Acquiring 'control' includes where a person first holds 10% or more of the shares or voting power in the Bank directly or indirectly via the Holding Company. Increasing control means when an existing shareholder increases their shareholding or entitlement to voting power from a holding below certain thresholds to a holding above them. The thresholds are 10%, 20%, 30% or 50% of shares or voting power.

Voting rights

Subject to the Bank's Articles of Association and to any special rights or restrictions as to voting for the time being attached to any shares, the provisions of the Companies Act 2006 shall apply in relation to voting rights of the Bank's shares.

Ordinary shareholders are entitled to vote at general meetings and appoint proxies. On a show of hands, every member or proxy has one vote. On a poll, every member present in person or by proxy has one vote for every share held. Ordinary shareholders may receive: (1) dividends; (2) assets upon the liquidation of the Bank; and (3) capital payments through the capitalisation of reserves as provided in the Bank's Articles of Association.

Subject to the provisions in the Holding Company's Articles of Association, no A ordinary shareholder shall be entitled to receive notice of, nor attend or vote at a general meeting of the Holding Company, save for resolutions being proposed in respect of:

- abrogating or varying any respective rights or privileges attaching to the A ordinary shares;
- for the winding up or dissolution of the Holding Company;
- in respect of the purchase or redemption (save for the redemption of the B shares in accordance with the Articles of Association) of any share capital of the Holding Company; or
- In respect of a Bank Exit or IPO Exit.

B redeemable preference shareholders are entitled to receive notice, attend and vote at a general meeting of the Holding Company in accordance with the Holding Company's Articles of Association.

Where shareholders of the Holding Company are entitled to vote at a general meeting on a show of hands every holder or proxy shall have one vote and on a poll, shall have one vote in respect of each respective share registered in the name of the holder.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Annual Report and Accounts and the consolidated financial statements of The Co-operative Bank Holdings Limited and its subsidiaries (the Group), the consolidated financial statements of The Co-operative Bank plc and its subsidiaries (the Bank) and Parent Company financial statements for The Co-operative Bank Holdings Limited (the Holding Company) and Parent Company financial statements for The Co-operative Bank plc (the Bank Company) in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group, Bank, Holding Company and Bank Company financial statements for each financial year. Under that law they have elected to prepare the Group, Bank, Holding Company and the Bank Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and applicable law.

Under Company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group, Bank, Holding Company and Bank Company and of their income statements for that year. In preparing each of the Group, Bank, Holding Company and Bank Company financial statements, the Directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs as adopted by the EU is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and
- state that the Group, Bank, Holding Company and Bank Company have complied with IFRSs as adopted by the EU, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's, Bank's, Holding Company's and Bank Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group, Bank, Holding Company and Bank Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group, Bank, Holding Company and Bank Company and to prevent and detect fraud and other irregularities.

The Directors are also responsible for preparing, in accordance with applicable laws and regulations, a strategic report, Directors' report and Corporate Governance statement that complies with that law and those regulations. The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Bank's website.

Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Disclosure of information to the Auditor

So far as the Directors are aware, there is no relevant Audit information of which the Group and Bank's Auditor is unaware, and the Directors have taken all steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Group and Bank's Auditor is aware of that information. We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and income statement of the Group and Bank and of the undertakings included in the consolidations taken as a whole;
- the strategic report includes a fair review of the development and performance of the business and the position of the Group, Bank, Holding Company, Bank Company and the undertakings included in the consolidations taken as a whole, together with a description of the Principal risks and uncertainties that they face; and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's, Bank's, Holding Company's and Bank Company's performance, business model and strategy.

This responsibility statement was approved by the Board of Directors of the Holding Company and Bank Company on 13 March 2018 and is signed on its behalf by:

Dennis Holt
Chairman
13 March 2018

DIRECTORS' REPORT ON REMUNERATION

Note that all employees are employed by the Bank and governed by the Bank's Remuneration Committee.

Dear Shareholder,

I am pleased to present our Directors' report on remuneration for 2017 for Group and Bank. Our full Directors' remuneration policy, which was re-approved at the 2016 AGM, remains unchanged in 2017 and for 2018 and can be found on https://www.co-operativebank.co.uk/assets/pdf/investorrelations/annual-report.pdf.

Looking back on 2017

A summary of matters considered by the Remuneration Committee in 2017 is set out in pages 60 to 65. During the first half of the year, the Committee focused on the Restructuring and Recapitalisation and gave careful consideration to the implications for remuneration. Specifically, the Committee was required to determine the treatment of outstanding deferred awards under previous annual and on-going long term incentive plans. The Committee also recommended that there should be no new Long Term Incentive Plan for 2017.

CRD IV restrictions continued to constrain the ability to award variable pay during 2017. As a result, the Committee kept the application of its wider pay policies under review to ensure it continued to provide competitive levels of remuneration, while remaining in compliance with these regulatory constraints. At the end of 2017, Executive Directors and the Committee considered it was important to recognise the contribution of the wider workforce during such a critical year and therefore implemented a single year end payment in respect of 2017 for colleagues below senior levels, equivalent to 3% of base salary. Targeted adjustments to individual base salaries were also applied where appropriate to recognise high performance and ongoing criticality to the business.

Executive performance was a key area of focus during 2017 both in terms of the Restructuring and Recapitalisation and also in ensuring delivery of the longer term Plan. Risk policies and reporting processes have been further strengthened, with detailed quarterly reports from the Chief Risk Officer to the Remuneration Committee, and a regular structured review of material events by the Risk Adjustment and Individual Risk Adjustment Committees. Malus and clawback policies continue in force, and are taken into account by the Bank's Individual Risk Adjustment Committee when considering the effects of major risk events before referral to the Remuneration Committee to consider any action required.

Maureen Laurie stepped down from the Board in September 2017 and we thank her for her contribution as Chair of the Remuneration Committee from June 2014 through to this date. We also thank Aidan Birkett, who undertook the role of Interim Chair of the Committee between September and December.

Remuneration Committee agenda for 2018

As we move forward following the Restructuring and Recapitalisation, ensuring strong performance of our key Executives will be critical to achieving a sustainable and profitable bank. During 2018, the Committee will continue its close monitoring of progress against plan and individual performance. Allied to this focus on performance, the risk policies and reporting processes outlined above will remain central to the Committee's agenda.

The CRD IV restrictions constraining the ability to award variable pay will no longer apply from 2018, and the Committee will consider the options for variable pay as a result. The Committee will therefore review options for long term incentive awards to selected key staff in 2018. Should any awards be made, these will vary subject to both corporate and individual performance in accordance with regulatory requirements and will remain within the parameters set out in the approved policy. In considering any approach, we will remain committed to ensuring our reward framework continues to align our Executives with shareholder expectations, as well as the customer experience. The Committee will also consider the options for variable pay as a result. The Committee will continue to consult with the Value and Ethics Committee on certain aspects of remuneration policy.

The Co-operative Bank was one of the first companies to publish Gender Pay Gap figures in November 2017. The Committee will continue to monitor progress towards our Women in Finance target of 40 per cent of senior management roles occupied by women in 2020, which will address our Gender Pay Gap which is the result of fewer women than men in senior management positions.

On behalf of the Committee, I would like to thank you for your continued support.

Bill Thomas
Chair, Remuneration Committee
13 March 2018

Remuneration Committee
The Remuneration Committee has the delegated responsibility to determine remuneration for the Executive Directors and the Executive Committee of the Bank and Directors of the Holding Company. It sets, and recommends to the Board for approval, the overarching principles and parameters of the Remuneration policy across the Bank and applies the necessary oversight to ensure an overall coherent approach to remuneration is implemented for all employees.

During 2017, the members of the Remuneration Committee were as follows:

Committee members	Date of appointment	Date resigned as a Committee member
Maureen Laurie	Appointed 30 June 2014	Resigned 1 September 2017
Aidan Birkett	Appointed 1 July 2016 Interim Chair from 26 September 2017 to 19 December 2017	
Dennis Holt	Appointed 5 February 2014	Resigned 27 September 2017
Laura Carstensen	Appointed 30 May 2014	
Derek Weir	Appointed 26 September 2017	
William Thomas (Chair)	Appointed 26 September 2017 Chair from 19 December 2017	
Charles Bralver	Appointed 26 September 2017	

In 2017, the Committee's business agenda required nine meetings to allow consideration of the ongoing impact of CRD IV on remuneration policy, implications for remuneration of the Bank's proposed sale process and subsequent Restructuring and Recapitalisation and succession changes for the Executive Committee, in addition to regular business items.

The Committee continues to regularly consult with the Chief Executive Officer (CEO), Human Resources Director (HRD), General Counsel and Chief Risk Officer (CRO), all of whom may attend meetings of the Committee but are not present when their own remuneration or terms and conditions are being considered. The Head of Reward also provides advice on compensation and benefits to the Committee. The General Counsel and Company Secretary advises the Committee on corporate governance.

The Committee also works closely with Chairs of the Risk Committee, Audit Committee, Nomination Committee and Values and Ethics Committee.

Advisor to the Committee
The Committee received support and advice from external advisors during the year. The table below provides details of the external advisors to the Committee and the fees paid to them in 2017. Fees are charged based on the scope and requirements of the work, as agreed with the Committee or the Bank as a whole. Deloitte LLP is a member of the Remuneration Consultants Group and, as such, voluntarily operates under the code of conduct in relation to 'Executive remuneration consulting in the UK'.

The total fee paid in 2017 to remuneration advisors for remuneration-related advice to the Committee was:

Name	2017 Fees £000s	2016 Fees £000s
Deloitte LLP[1]	**37**	112

1. The figure above captures only the fees for services in respect of advice that materially assisted the Remuneration Committee.

The Committee last reviewed the provision of advice in 2015 and with regard to the position of the Bank considered it appropriate to retain Deloitte as advisor during 2017.

Principal responsibilities and key areas of discussion of the Committee on behalf of the Bank

Principal responsibilities of the Remuneration Committee	Key areas discussed and reviewed by the Committee in 2017 include
Remuneration policy • Policy and contractual terms including salary, benefits and pension; • Set and recommend to the Board for approval, the overarching principles and parameters of the remuneration policy to ensure an overall coherent approach to remuneration in respect of all employees. Ensure that all relevant legislation, regulatory requirements and guidance on remuneration practice are considered and complied with when setting the remuneration policy; • Support the Chairman of the Committee in overseeing the development and implementation of the Bank's remuneration policy and supporting practices; • The remuneration policy should have regard to the risk appetite of the Bank, whilst being consistent with effective risk management principles, be aligned to the long term strategic goals, and comply with relevant applicable legislation; and • Review at least annually the ongoing appropriateness and relevance of the remuneration policy and exercise its judgement in the application of the remuneration framework and policies to promote the long term success.	• The Committee reviewed the Bank's remuneration policies, with regard to CRD IV restrictions introduced in 2016, constraining the Bank's ability to award variable pay; and • In view of these continued regulatory constraints, the Committee reviewed the arrangements put in place in 2016 to ensure they remained appropriate. The Committee also considered the approach to remuneration going forward, in light of the lifting of these restrictions for 2018 onwards.
Material Risk Takers • Review and agree the Remuneration policy and decisions relating to remuneration, including variable pay, performance related payments and pension arrangements, for any employees, present and prospective, in senior management roles, risk takers and staff in control functions that are included on the Bank's register of Material Risk Takers and therefore subject to the Remuneration Code; and • Seek advice from the Board's Risk Committee, the Chief Risk Officer (by way of quarterly reports from the Chief Risk Officer) and consider the impact of Income Recognition and Asset Classification and provisioning (IRAC) on the risks arising from the remuneration policies for the purpose of the ICAAP within the key areas discussed and reviewed by the Committee in 2017 and other regulatory matters and specific risk adjustments to be applied to performance objectives of any Material Risk Takers, set in the context of incentive packages.	• The Committee strengthened the review process for Remuneration Policy Statement (RPS) reporting to the PRA and in doing so approved the list of designated Material Risk Takers in 2017; and • Risk policy reporting processes were further strengthened, with detailed quarterly reporting to the Committee from the Chief Risk Officer, together with a structured review and consideration of material events by the Bank's Risk Adjustment Committee and Individual Risk Adjustment Committee.
Executive Directors and the Executive Committee (the Executive) Having regard to the overarching principles and parameters of the Bank's remuneration policy: **Policy and contractual terms:** • Establish, implement and maintain the policy on all aspects of the remuneration of the Executive present and prospective, including pension rights and any compensation payments; • Review at least annually the on-going appropriateness and relevance of the Remuneration policy; • Oversee contractual arrangements and approve the principal terms and conditions of employment; • Ensure that contractual terms on termination, and any payments made, are fair to the individual, and the Bank, that failure is not rewarded and that the duty to mitigate loss is fully recognised; • Within the terms of the agreed policy and in consultation with the Chair and/or Chief Executive, as appropriate, determine the total individual remuneration package of each Executive and the Chair, ensuring full compliance with the relevant legislation and regulatory requirements; • Ensure that the remuneration of each Executive (including any payments for loss of office) is consistent with the most recently approved Remuneration policy; • Review salaries, normally at the start of the financial year, which may include reference to comparisons against the agreed financial services sector market policies; and • Advise on any major changes in employee benefit structures throughout the Bank or its subsidiaries which relate to Executives.	• A revised Executive pay structure was approved. Remuneration for the new Chief Executive Officer and Chief Financial and Restructuring Officer was approved, together with a review of Executive Committee accountabilities. The changes satisfy regulatory requirements, whilst ensuring performance priorities, risk and reward are all aligned with strategic objectives.

Principal responsibilities of the Remuneration Committee	Key areas discussed and reviewed by the Committee in 2017 include
Incentive arrangements – annual and long term • Determine and review the policy for all incentive plans for approval by the Board and shareholders in accordance with the agreed Remuneration policy; • Approve any amendments to all incentive plans prior to obtaining any necessary shareholder approval; • For any such plans, determine each year whether awards will be made, and if so, the overall amount of such awards, the individual awards to be made and set appropriate performance targets. Ensuring that appropriate consideration has been taken for risk matters and events that have occurred both in year and in prior years; • Authorise payments under incentive plans, subject to the achievement of performance and balanced scorecard metrics, and underpin as applicable, and in accordance with the rules of the plan; • Authorise the application of the malus and clawback policy in relation to specific individual adjustments that may be agreed through the risk adjustment review process; • The Committee shall determine the design, performance measures and associated targets for any performance related pay schemes operated by the Bank in respect of Executives and Material Risk Takers and review individuals' performance against those targets and agree any payments proposed; and • The Committee shall consider not less than annually whether or not it is necessary to apply malus and/or clawback in relation to the performance related pay schemes.	• With regard to the unvested 2014, 2015 and 2016 Long Term Incentive Plans, the Committee has monitored and recorded progress against the agreed financial and non-financial performance measures. • Decisions were taken by the Committee with regard to the impact of the Restructuring and Recapitalisation on these Plans and any deferred bonuses, which were linked to the Bank's share price. • In addition the Committee considered, but ultimately decided not to recommend, that the Bank or Holding Company proceed with a new Long Term Incentive Plan for 2017. • The Committee received quarterly reports from the Chief Risk Officer, together with recommendations from the Individual Risk Adjustment Committee, to regularly consider material events and whether or not malus and/or clawback should be applied to variable pay awards, in relation to these events.

Remuneration policy and practices

The Bank's remuneration structures are designed to align with its values and ethics and aims to promote the long term sustainable success of the business.

Fixed remuneration, which includes salary for all employees and role based allowances for Executives and certain other senior roles, is set having regard to individual roles, scope of responsibilities and experience, together with internal and external benchmarks.

Variable pay, which includes annual and long term incentive plans, aims at rewarding individual and collective performance achieved in a manner consistent with the Bank's values and ethics and within the Bank's risk appetite.

A range of employee benefits, including core, voluntary and flexible benefits, and a defined contribution pension scheme are also provided.

In setting remuneration policies the Remuneration Committee seeks to:

- link reward to business and individual performance, ensuring that performance metrics are balanced so as not to encourage undue/inappropriate risk;
- ensure that the remuneration of senior management can be justified clearly by reference to independently sourced market data on comparable organisations, and is set in a manner broadly consistent with the systems used to determine pay for employees elsewhere in the Bank, taking into account quantum, market comparators and affordability;
- determine the specific conditions for variable annual and longer term pay so that these are financially prudent, directly aligned to approved strategic plans and thus support and drive long term sustainability; and
- establish measures which explicitly reward the ongoing support for co-operative values and ethics.

Policy for variable annual and long term remuneration incorporates the use of a Balanced Scorecard which is directly aligned to the Financial Plan. This scorecard includes non-financial measures to ensure that there is no encouragement of inappropriate risk taking (compliance with the Risk Management Framework) and awards may not be made if underlying capital conditions are not met. Variable remuneration awarded to employees whose roles have a material impact on the Bank's risk profile meets with CRD IV requirements. This includes appropriate deferral of awards and risk adjustment through malus and clawback provisions.

Risk is assessed by quarterly reporting, presented by the Chief Risk Officer (CRO) to the Remuneration Committee, which directly draws on the risk report submitted to the Risk Committee.

Where breaches have been identified, the Bank's Risk Adjustment Committee (RAC) meets to determine if these are considered material. Material Risk Events are then reported to the Bank's Individual Risk Adjustment Committee (IRAC), which looks at individual impact and accountability for such breaches. IRAC reports directly to Remuneration Committee with recommendations for actions, including consideration of risk adjustments to variable pay awards.

In order to ensure full scrutiny and separation of interests, the proposers of any such actions are (i) Chairman, in respect of Executive Directors, (ii) CEO for Executive Committee members, excluding the Chief Financial and Restructuring Officer, and (iii) HRD for all other colleagues.

Variable pay features
The Bank’s policy includes a discretionary annual bonus plan, the Annual Incentive Plan (AIP).

AIP awards are determined by reference to the performance against a scorecard of combined financial, strategic, cultural and risk performance metrics, which are reviewed annually by the Remuneration Committee.

In 2017 the Bank continued to be constrained, however, under the requirements of CRD IV regulations, and so no AIP awards were made in respect of the year.

Senior Colleagues (Executive Committee and certain Material Risk Takers) also have access to grants under a Long Term Incentive Plan (LTIP), as provided under our approved policy.

Under the rules of the LTIP, performance will be tested at the end of the plan, including an assessment of compliance with CRD IV requirements, at which point, if applicable, variable payments will be made.

- Assessment of performance for the LTIPs will take into consideration achievement against the specified metrics to determine a maximum payment. Risk matters throughout the plan period will be considered by the Remuneration Committee, to determine if adjustments should be made before an overall achievement is agreed.
- Malus and clawback policies apply to all such plans.
- If the Bank is not capital compliant at the time of performance being assessed, regardless of the achievement against the plan metrics, no award will be made.

The performance of the plans, vesting at the end of 2017, were reviewed by the Committee and decisions taken regarding the outcome of these plans taking in to consideration the Restructuring and Recapitalisation exercise. Further, in view of the Bank’s proposed sale process and subsequent Restructuring and Recapitalisation during 2017, the Remuneration Committee considered but decided not to grant any awards in 2017, under a Long Term Incentive Plan.

The last LTIP award granted, therefore, was in 2016, the performance conditions of which are described below:

Performance measures	Weighting	Threshold	On-target	Maximum vesting
Cost:income ratio	25%	25% of award vests for cost:income ratio of 67.6%	60% of award vests for cost:income ratio of 60.8%	100% of award vests for cost:income ratio of 55.3%
Absolute Total Shareholder Return (TSR) per share	25%	25% of award vests for absolute TSR per share of 8% per annum.	60% of award vests for absolute TSR per share of 12% per annum.	100% of award vests for absolute TSR per share of 20% per annum.
Total Bank Profitability	20%	25% of award vests for ’Profit before Tax’ of £86.3m	60% of award vests for ‘Profit before Tax’ of £95.9m	100% of award vests for Profit before Tax’ of £105.4m
Total Financial measures	**70%**			
Risk and Control	10%	Performance against strategic measures will be assessed by the Remuneration Committee using individual scorecard ratings ranging from 1 – 10, with 50% of the award vesting at the threshold rating of 5. The detailed targets within each measure are not disclosed as these are deemed to be commercially sensitive. Retrospective disclosure will be provided in the 2019 Directors’ report on remuneration, subject to commercial sensitivity no longer remaining.		
People	10%			
Customer	10%			
Total Strategic Measures	**30%**			
Total	**100%**			

The 2016 LTIP award takes the form of cash, which is linked to the Holding Company’s share price and is subject to the Group’s CET1 ratio being maintained at or above the regulatory minimum through the three year (2016–2018) performance period. Failure to meet the minimum regulatory CET1 hurdle will result in a 0% pay out, irrespective of the levels of performance against any other targets. Following a further 24 month qualifying period, an additional test for capital compliance will be conducted to determine whether and to what extent awards can be paid out, in accordance with CRD IV regulations.

Control Function remuneration
Remuneration for Control Functions is not determined within the business unit alone, in order to avoid conflicts of interest. The split between fixed and variable pay is reviewed annually by the Remuneration Committee, to ensure it continues to reflect best practice.

The level of any pay increases or variable pay awards is directly linked to individual performance ratings. Such ratings are determined against objectives specific to Control Function roles, which do not relate or impact to the business areas they control. When attracting staff to fill a vacant Control Function role, external market data, internal relativity and remuneration policy are used to determine an appropriate remuneration package.

Ratio between fixed and variable pay

The Bank applies the Material Risk Taker variable remuneration cap. Variable remuneration for Material Risk Takers cannot, therefore, exceed twice the amount of their fixed remuneration. Shareholder approval, for the maximum '2 x fixed remuneration' ratio was received in May 2014, the voting at which is shown in the table below:

Resolution		Votes for	% of votes cast	Votes against	% of votes cast	Total votes validly cast	Votes as % of issued ordinary share capital[1]	Votes withheld
14[2]	To authorise the Bank to apply a ratio of the fixed to variable components of total remuneration for 'Remuneration Code Staff' that exceeds1:1, provided that the ratio does not exceed 1:2	202,502,426	99.55%	919,591	0.45%	203,422,017	81.37%	-

1. 250,000,000 ordinary shares, being the Bank's issued voting share capital as at 6.00pm on 28 May 2014, the time by which shareholders who wanted to attend and vote at the AGM must have been entered on the Bank's register.
2. Resolution 14 was a special resolution.

The application of the variable remuneration cap is reflected in the full Director's remuneration policy, which was re-approved by shareholders at the 2016 AGM and remains unchanged for 2018.

Guaranteed variable pay, buy outs and severance payments

In line with the Remuneration Code, the Bank does not award guaranteed variable remuneration, except where necessary in the first year of employment to reflect loss or forfeit of previous employer awards, and provided the Bank has a strong capital base.

Retention bonuses will not be used, other than in exceptional circumstances.

All buy-out and retention awards are subject to the Bank's 'Malus and Clawback policy'.

Any payments on termination of employment will be in accordance with the provisions of CRD IV. In line with regulatory requirements, any payments in relation to early termination will reflect performance achieved over time and will not reward failure or misconduct. Any payments made to MRTs on termination of employment will be considered as to whether they should be subject to the variable pay cap and/or relevant pay-out process rules.

Typically, termination payments will consist of basic salary and other contractual benefits for the notice period.

The standard notice period is 12 months from the Bank and 12 months from the Executive Directors. In normal circumstances, Executive Directors will be required to work their notice period. In the event Executive Directors are not required to fulfil their notice period, they will receive a payment in lieu of notice, or they may be placed on garden leave. Other Material Risk Takers have notice periods varying between 6 and 12 months, depending on the role undertaken.

Statutory redundancy payments may also be made, when appropriate. In accordance with EBA guidelines, such statutory payments are not taken into account for the purpose of calculating the ratio between variable and fixed remuneration.

Comparison of Executive Director Remuneration policy with the wider employee population

The Bank has one Remuneration policy that is communicated and applied throughout the organisation. Our policy has been designed to support recruitment, motivation and retention and to encourage the highest standards of performance within the Bank's risk appetite. The policy is specifically aligned to the Bank's Values and Ethics policy and a report is provided to the Values and Ethics Committee each year.

The principles set out in the Remuneration policy inform decisions for all employees, including Executive Directors. The Remuneration Committee takes into account pay levels and benefit arrangements throughout the Bank to ensure the arrangements provided to Executive Directors are appropriate.

Remuneration packages may vary to take account of role-specific factors in different areas and are determined by reference to market levels, skills requirements and internal relativities:

- Annual Incentive Plan (when applicable) – Corporate performance measures are consistent for Executive Directors and other employees; the level of bonus opportunity differs by role to reflect levels of accountability and contribution to results. Bonus awards payable to employees classified as Material Risk Takers for regulatory purposes are subject to deferral and part-payment in shares/share-like instruments in accordance with regulatory requirements; and
- Long Term Incentive Plan – A limited number of Senior Executives may be invited to participate in the Long Term Incentive Plan, having regard to accountability for delivery of the Plan and strategy. The terms of the Long Term Incentive Plan apply equally to all participants, including Executive Directors.

The Remuneration Committee receives and considers internal and external information as appropriate to guide decisions on remuneration including, but not limited to, the results of employee satisfaction surveys and feedback sought from internal stakeholders (such as the CRO and Values and Ethics Committee) and external stakeholders.

Pillar 3 disclosures on Material Risk Takers

The Remuneration Committee is required to oversee remuneration for staff identified as Material Risk Takers.

Under the implementation of the European Capital Requirement Directive (CRD IV), new rules on remuneration were introduced with effect from 1 January 2014, and the definition of Material Risk Takers was revised. As part of these changes, the European Banking Association (EBA) published Regulatory Technical Standards containing qualitative and quantitative criteria to identify staff considered as Material Risk Takers, due to their professional activities having a material impact on the institution's risk profile.

During 2017, 63 Material Risk Takers were identified according to these criteria. This is lower than during the previous year (74), largely due to further re-organisation and review of the governance frameworks and reporting lines, as well as levels of attrition. The list of Material Risk Takers was approved by the Remuneration Committee. Material Risk Takers are subject to the PRA Remuneration Code provisions which are applied in their remuneration arrangements and include:

- the deferral of at least 40-60% of their variable remuneration over a period of at least three years;
- the delivery of at least 50% of their variable remuneration in the form of shares or share-linked instruments; and
- risk adjustment of any variable remuneration award, including: malus/clawback on Annual Incentive Plan, Deferred Bonus Plan and Long Term Incentive Plan awards. In particular, for any award made on or after 1 January 2015, clawback may apply for up to seven years following award.

While operating under the CRD IV restrictions on variable pay, no Annual Incentive Plan will be offered. The above requirements will be addressed, as they apply, purely to LTIP awards.

Risk adjustment of remuneration, including malus and clawback, is decided by the Remuneration Committee on the basis of information provided by internal control functions, reporting through the risk governance structure and an independent report provided by the Chief Risk Officer. This section discloses the remuneration awards made to Material Risk Takers in respect of the 2017 performance year.

1. Aggregate remuneration – all staff

	2017		
Total Number of Staff[1]	**Total Fixed Remuneration £m**	**Total Variable Remuneration £m**	**Total Remuneration £m**
3,864	129.4	-	129.4

1. Figures are based on the Bank's employee population as at 31 December 2017.

2. Aggregate remuneration – by division

	2017	
Division	**Number of Material Risk Takers**	**Total Remuneration[2] £m**
Retail & Business Banking[1]	9	3.1
Corporate Functions	37	10.3
Internal Control Functions	17	3.0
Total	63	16.4

1. CEO included in Retail & Business Banking division, Non-Executive Directors included in Corporate Functions.
2. Total Remuneration is the amount of remuneration paid during the year i.e. pro-rated for joiners and leavers.

3. Aggregate remuneration – Senior Management and other Material Risk Takers

	2017	
	Number of Material Risk Takers	**Total Remuneration £m**
Senior Management[1]	21	9.7
Other	42	6.7
Total	63	16.4

1. Senior Management consists of Non-Executive Directors, Executive Directors and Executive Committee members only.

4. Aggregate remuneration – by fixed/variable remuneration

	2017	
	Senior Management £m	Others £m
Total fixed remuneration[1]	9.7	6.7
Total	9.7	6.7

1. Includes pension contribution. There were no AIP awards made in 2017 due to CRD IV constraints, no deferred bonus awards made in 2017 and also no Long Term Incentive Plan awards made in 2017.

5. Aggregate remuneration – deferred remuneration

	2017	
	Senior Management £m	Others £m
Unvested deferred remuneration from previous years[1]	0.6	0.2
Deferred remuneration from previous years paid out in 2017[2]	0.3	0.1
Deferred unvested remuneration outstanding at 31 December 2017	0.3	0.1

1. The total deferred amount for both Senior Management and Others includes awards from the 2014 Transitional Deferral Awards Plan (TDAP), 2014, 2015 AIPs and LTIPs and 2016 LTIPs, together with retention and bonus buy-out awards also subject to deferred payment schedules.
2. Represents the value of previously deferred 2014 AIP awards vesting in 2017.

6. Aggregate remuneration – sign-on and severance payments

	2017		
	Number of beneficiaries	Senior Management £000s	Others £000s
Sign on payment[1]	0	-	-
Severance Payment[2]	2	-	51

1. No sign-on or buy-out payments were made in 2017.
2. There were 2 severance payments made in 2017 totalling £50,757. The largest single payment was £26,920.

7. Aggregate remuneration – High earners by band

Number of staff with total remuneration of EUR 1 million or more in 2017, by band[1]	2017
€1m – €1.5m	-
€1.5m – €2m	1
€2m – €2.5m	-
€2.5m – €3m	1
€3m – €3.5m	-
Above €3.5m	-

1. In accordance with Article 450 of the Regulation under CRD IV, the reporting of aggregate remuneration - high earners by band is prepared in Euros; using the rates published by the European Commission for Financial Programming and Budget for 29 December 2017 (1 GBP is equal to 1.1271 Euro).

Risk Management

RISK MANAGEMENT

1. Risk Management objectives and policies

1.1 Overview

The Board oversees and approves the Bank's Risk Management Framework (RMF) and is supported by the Risk Committee of the Bank. The Risk Committees purpose is to review the Bank's risk appetite and report its conclusions to the Board for approval, oversee the implementation of the RMF, taking a forward-looking perspective and anticipating changes in business conditions. The purpose of the Risk Committee of the Board of the Holding Company is to review and challenge the Bank's risk appetite and RMF, and approve the Holding Company's risk appetite and risk policy which shall be aligned to the RMF.

There is a formal structure for identifying, reporting, monitoring and managing risks. This comprises, at its highest level, Risk Appetite statements which are set and approved by the Board and are supported by granular Risk Appetite measures across the principal risk categories. This is underpinned by an RMF which sets out the high level policy, standards, roles, responsibilities, governance and oversight for the management of all principal risks.

During 2017 the formal RMF programme was concluded. This focused on aligning roles and responsibilities between the 1st and 2nd lines of defence, updating the policy framework and the risk focussed committee structure. Work continued through 2017 to drive greater consistency in the application of the RMF, including the further development of operational risk stress testing and scenario analysis using the principal risk categories, development of a Reverse Stress Testing methodology and more structured use of external operational risk loss data.

Material risks and issues, whether realised or emerging, inclusive of those observed in relation to the RMF itself are detailed within section 1.6.

1.2 Approach to Risk Management

Responsibility for Risk Management resides at all levels and is supported by Board and management level committees. A three lines of defence model is deployed on the following basis:

- 1st Line - The business teams are the Risk Owners (ROs) and sit within the 1st Line of defence. ROs are responsible for owning and managing all risks within defined appetites, ensuring supporting procedures are written, and are responsible for reporting the performance, losses, near misses and status of risks through governance;

- 2nd Line - The Compliance and Risk functions act as the 2nd Line of defence. The Risk Framework Owners (RFOs) generally sit within the 2nd Line and where there are exceptions for some specialist areas, and the RFO sits within 1st Line (for example Legal and Financial Reporting), the 2nd line Risk Function will provide oversight over the RFO activities; and

- 3rd Line - The Internal Audit function assesses the adequacy and effectiveness of the control environment and independently challenges the overall management of the RMF.

1.3 Risk Management strategy and appetite

The Board has primary responsibility for identifying the key business risks faced, approving the Risk Management Strategy through the setting of Risk Appetite which defines the type and amount of risk the firm is prepared to take both qualitatively and quantitatively in pursuit of its strategic objectives. In addition, the Board approves key documents including the Internal Liquidity Adequacy Assessment Process (ILAAP) and the Internal Capital Adequacy Assessment Process (ICAAP).

Risk Appetite is translated into specific risk measures which are tracked, monitored and reported to the appropriate Risk Committees (refer to section 1.5). The Risk Appetite framework has been designed to create clear links to the strategic planning process whereby appropriate metrics and limits for each risk category are established, calibrated and reported.

1.4 Principal risk categories

The RMF sets out the principles that define the risk taxonomy, identifies processes, ownership, responsibilities and the risk oversight required to support effective implementation of risk management. The constituent parts that cover the risk taxonomy are shown below:

Principal risk	Definition	Further constituent parts / Risk Taxonomy
Capital risk	The risk that regulatory capital is inadequate to cover capital requirements.	
Credit risk	The risk to earnings and capital arising from a customer's failure to meet their legal and contractual obligations.	• Credit risk Treasury • Credit risk Retail • Credit risk Corporate
Model risk	The potential for adverse consequences caused by models. Model risk can lead to financial loss, regulatory penalty or fine, poor business or strategic decision making, incorrect financial reporting, damage to reputation or adverse customer outcome.	
Market risk	The risk of loss as a result of the value of financial assets or liabilities (including off-balance sheet instruments) being adversely affected by the movement in market prices, interest rates or exchange rates.	
Pension risk	The risk to capital and funds from exposure to defined benefit scheme liabilities (to the extent that liabilities are not covered by scheme assets) and risks inherent in the valuation of scheme liabilities.	
Strategic risk	The risk to the delivery of the Financial Plan.	
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events.	• Regulatory risk • Conduct risk • Product risk • Fraud risk • AML risk • Financial reporting risk • Information & data risk • Payments risk • Legal risk • Technology risk • Change risk • People risk • Third party supplier risk • Physical assets risk (including health & safety) • Insurance risk • Business continuity risk
Liquidity and Funding risk	The risk that obligations cannot be met as they fall due or can only be met at excessive cost.	
Reputational risk	The risk of damage to reputation, brand or image as perceived by internal or external stakeholders as a result of conduct, performance, or the impact of operational failures or other external issues.	

1.5 Governance

The Board is the key governance body and is responsible for the strategy, performance, and ensuring appropriate and effective risk management. It has delegated responsibility for the day-to-day running of the business to the Chief Executive. The Chief Executive has established the Executive Committee to assist in the management of the business and deliver against the approved plan in an effective and controlled manner.

The Board has established Board Committees and senior management committees to oversee the RMF, including identifying the key risks faced and assessing the effectiveness of any risk management actions. As at year end 2017, the formal committees which oversee the effective management and oversight of the RMF are detailed in the table below:

Committee	Reports to:	Risk focus
Board		The Board has collective responsibility for the long term success of the Group and Bank. Its role is to provide leadership of the firm within a framework of prudent and effective controls which enable risk to be assessed and managed. It sets the values and standards and ensures that its obligations to its shareholders, customers and other stakeholders are understood and met. The Board sets the strategy and approves plans presented by management for the achievement of the strategic objectives it has set. It determines the nature and extent of the significant risks it is willing to take in achieving its strategic objectives and is responsible for ensuring maintenance of sound risk management and internal control systems.
Risk Committee (RC)	Board	In conjunction with the Audit Committee, the purpose of the Risk Committee is to review and challenge the risk appetite and RMF, and approve the risk appetite and risk policy which shall be aligned to the RMF.
Executive Committee (ExCo)	CEO	ExCo is responsible for defining and successfully implementing the Board approved strategy by monitoring and managing delivery against plan and applying appropriate risk management actions to emerging risks.
Bank Restructuring Committee (BResCo)[1]	ExCo	BResCo is responsible for developing and monitoring the implementation of the restructuring agenda.
Executive People Committee (EPC)	ExCo	EPC provides assurance on the effectiveness of people management policies and procedures.
Asset and Liability Committee (ALCo)	ExCo	ALCo is primarily responsible for overseeing the management of capital, market, earnings, liquidity and funding risks. Its responsibilities include identifying, managing and controlling the balance sheet risks in executing its chosen business strategy, ensuring that the capital and liquidity position is managed in line with policy and that adequate capital is maintained at all times.
Enterprise Risk Oversight Committee (EROC)	ExCo	EROC provides a mechanism to ensure all risks are reviewed, challenged and approved in line with decisions made at the ExCo (with escalation to RC where required). EROC achieves some of its objectives through delegating responsibility to sub-committees, Conduct & Regulatory Risk, Operational Risk, Pension Risk and Credit Risk Oversight Committees. EROC will escalate where appropriate to the Board via RC.
Model & Rating System Oversight Committee (MRSOC)	ExCo	MRSOC ensures, on an ongoing basis, that the model rating systems and material models are operating effectively. This includes providing Executive level review and challenge of the model risk and the impact on the business strategy. This is achieved through, but is not limited to, providing approvals relating to high materiality models and other approvals, such as any Temporary Model Adjustments (TMAs), which are independent of model materiality.
Technology Steering Committee (TSC)	ExCo	TSC acts to support the Chief Technology Officer (CTO) in developing and executing the IT strategy. The TSC provides a forum for Executive input to strategic IT decisions, policy, planning and prioritisation, maintaining alignment between IT strategy and business strategy. TSC assess potential risks and benefits from future technology changes.
Project Oversight Committee (POC)	BResCo	POC is responsible for overseeing and challenging the delivery of the change portfolio ensuring there is clarity of delivery outcomes, that benefits are delivered within the agreed time, cost and quality thresholds, that sponsors have the necessary Executive support to deliver successfully and that key risks and issues threatening delivery are being effectively managed. This Committee ceased at the end of December 2017 with activities transferred to BResCo.
Bank Design Authority (BDA)	BResCo	BDA is a forum acting as the guardian of how the strategy is implemented. The committee oversees and directs strategic design choices relating to proposed changes to the operating model from a customer, business process, colleague, data, technology, finance, and risk perspective.
Diversity & Inclusion Committee (D&IC)	EPC	D&IC is responsible for providing strategic vision from an equality, diversity and inclusion perspective, recommending activities with regards to equality, diversity and inclusion in support of the Ethical Policy and promoting the importance of a diverse and inclusive culture in terms of equality, fair play and tolerance, and to improve diversity awareness and inclusion within our workforce.
Credit Risk Oversight Committee (CROC)	EROC	CROC is responsible for monitoring significant credit risks and issues with the entire credit life cycle, the controls and management actions being taken to mitigate them and to hold to account the Executives responsible for actions. CROC reviews the credit risk strategy on an ongoing basis making recommendations to EROC as appropriate.
Operational Risk Oversight Committee (OROC)	EROC	OROC is responsible for monitoring significant operational risks and issues, the controls and management actions being taken to mitigate them and to hold to account the Executives responsible for actions. OROC oversees the current and emerging operational risk profile ensuring key risk exposures are managed within risk appetite, and reported to EROC, as appropriate including the monitoring of adherence to the RMF including a process for continuous improvement.
Conduct and Regulatory Risk Oversight Committee (CRROC)	EROC	CRROC is responsible for monitoring significant conduct, regulatory, product, reputational, fraud and AML risks and issues, the controls and management actions being taken to mitigate them and to hold to account the Executives responsible for actions,
Pension Risk Oversight Committee (PROC)	EROC	PROC oversees all aspects of pension arrangements which the Group or Bank is either sponsor or participate in, to ensure cost, risk, capital, investment and employee requirements are met.
Model Risk Management Review Committee (MRMRC)	MRSOC	MRMRC supports MRSOC in ensuring, on an ongoing basis, that the rating systems and material models are operating effectively. This includes providing Executive level review and challenges of the model risk on the business strategy. This is achieved through, but is not limited to, providing approvals relating to medium materiality models.

1. Transformation Committee was ceased and incorporated into BResCo during Q4 2017.

1.6 Principal risks and uncertainties

The Principal risks and uncertainties detailed below primarily arise in relation to, and if material would impact the Bank as the Group's principal operating entity. However if any material risks materialise they would also impact the Group. Any specific Holding Company risks will be reported in subsequent years where applicable.

Where relevant the Group as a whole applies the same principal risk categories and risk management processes to Holding Company, Bank Company and their subsidiaries.

This section is comprised of three parts:

- 'Background' provides the context in which the principal risks and uncertainties should be understood;
- 'Regulatory Deficiencies' summarises the deficiencies against regulatory requirements and expectations which constitute principal risks and uncertainties; and
- 'Other key risks' outlines other key financial and non-financial risks and uncertainties as identified by the RMF and how they are being managed or mitigated. These are linked to the RMF risk taxonomy: see further 'Risk Management – section 1.4 Principal risk categories'.

1.6.1 Background

During 2017, the Group successfully completed the Restructuring and Recapitalisation which significantly improved its capital position. While greater levels of regulatory capital (CET1) are now held, the business, operating results, financial condition and prospects and/or ability to implement the strategy could be adversely impacted by, including, but not limited to:

- Future changes to regulatory capital requirements (for example MREL) driven by regulatory stress testing results; and
- A failure to successfully implement or a delay in implementing the Financial Plan and the consequent impact on the ability to comply with regulatory capital requirements which could lead to stress on ICG compliance.

Risks relating to the key assumptions in the Financial Plan (2018-2022) (the Plan)

The successful execution of the strategy and Plan requires the simultaneous execution of a number of business assumptions including an increasing income profile, implementing cost reduction initiatives, management of capital resources and loss-absorbing capacity and the other risks and uncertainties faced.

The key assumptions underlying the Plan include:

Net interest margin (NIM)

The Plan targets a widening of, and steady increase in, net interest margin over the medium term. A rise in the Bank of England base rate is one of the key enablers for this growth. Accordingly, if movements in the base rate do not follow those assumed in the Plan, it is likely that this will impact the future trajectory of net interest margin. The Plan also assumes a recovery in mortgage margins above current levels, if this does not materialise it will further suppress the ability to grow NIM.

The Plan assumes that the cost of attracting liquidity will reduce over its life primarily as a function of the pass back assumptions to liability customers as the Bank of England base rate increases. If the liquidity profile cannot be supported based on the assumed pass back assumptions this will result in an increase in the cost of liquidity, which will have an adverse impact on NIM.

The ability to achieve the net interest margin targets assumes market share is preserved over the life of the Plan. Competition is faced in all the core markets and there is a risk market share is lost to competitors and net interest margin and new mortgage business origination targets are not met. The heavy reliance on mortgage revenues to drive income may increase susceptibility to competitive risks.

The behaviour of mortgage customer at the end of their offer rate periods is an important assumption in deriving the forecasted net interest income and net interest margin within the Plan. Particularly the proportion of customers that revert to a reversionary product and the length of time they remain on this product. These behaviours are largely driven by factors outside of the Bank's control and therefore the risk exists that the observed behaviour going forward is different to that anticipated in the Plan.

A failure to grow net interest margin as planned could have a significant material adverse effect on overall financial condition, operating results and prospects.

Growing mortgage assets

The Plan targets growing customer assets in each of the five years, primarily driven by the Platform mortgage brand. There is a risk that the growth of these assets is significantly less than planned, that new mortgage origination may be significantly less than expected due to any number of internal or external factors, including a possible contraction of the UK mortgage market, or capacity to execute increased volumes, or that mortgage origination may be disrupted if the mortgage process outsourcer is unable or unwilling to perform services and/or that the pressure to achieve the targeted increases may create new conduct, legal and regulatory risks. There is also a risk in being unable to maintain access, at an appropriate cost, to liquidity to fund the requisite level of asset origination targeted in the Plan. Mortgage growth is further supported by consistent retention and redemption levels. There is a risk that if these levels are not delivered it may restrict the ability to grow the asset base.

Tier 2 / MREL
The ability to raise MREL-qualifying debt when needed, on acceptable terms including the coupon payable, or at all, may depend on market conditions at the point of issuance and perceived credit worthiness of the Group.

There is a risk of breaching MREL requirements if issuances cannot be made in line with the requirements, amounts and timescales of the regulator. Any breach of MREL requirements could lead the regulator to investigate whether the breach is indicative of a failure to meet threshold conditions and whether further action is necessary.

The Group received a non-binding indication of its Minimum Requirement of Eligible Liabilities (MREL) for 2017 and agreed a plan with the PRA which included the issuance of loss absorbing capital as part of the Restructuring and Recapitalisation. The Group has not received a revised non-binding indication for MREL but expects to do so during 2018. This requirement is expected to be set for the Group but applicable to the operations and resolvability of the regulated banking entity (The Co-operative Bank plc).

Transformation and Restructuring Activity/Delivery
The Plan assumes the ability, capability and capacity to deliver transformation/restructuring, remediation and change programmes and the cost reduction initiatives already underway without material deviation from planned timescales and costs. Historically, cost and delivery overruns have occurred when implementing complex large-scale change projects, and some projects have not delivered the planned benefits. Any deficiencies in appropriate governance and related programme management processes to assist with the satisfactory delivery of these activities would have an adverse effect on operating results and financial condition compared with those targeted in the Plan. There are risks of being unable to complete the planned programme of transformation, and/ or that it may cost significantly more than targeted or have a reduced scope for the same targeted costs, or deliver less benefits than planned, thereby impacting associated cost reductions or income generation plans.

Cost reduction
The Plan targets material reductions in cost throughout the life of the Plan. Operating cost reduction targets assume successful and significant cost reduction initiatives in the near term and that operating expenditure and project costs are significantly lower during the remaining years of the Plan than in recent years. There is a risk these intended cost reductions may not be achieved, when planned, or at all. Operating costs may be higher than expected and there is a risk that if this continues it could negatively impact profitability and the capital position.

Risk Weighted Assets (RWAs)
RWAs may be significantly greater than targeted due to unforeseen worsening economic conditions (e.g. higher unemployment and lower property prices) and any material increases in RWAs will significantly increase our capital requirements beyond those planned for.

Return to profitability
The targeted return to profitability relies on the ability to successfully mitigate the risks outlined above, particularly the ability to widen net interest margin and develop interest income, deliver the anticipated cost reduction and resulting cost:income ratio. If any of the risks above do materialise, this may result in lower future returns and lower than targeted profits.

The ability to deliver the Plan is heavily influenced by external factors which may mean that the underpinning internal assumptions may be incorrect and negatively impact performance. This may include an impact on profitability, RWA's and capital ratios. Many of these are similar to those faced by other financial institutions, for example:

- lower interest rates remaining lower for longer than forecast;
- deterioration in general economic conditions, instability of global financial markets including the effect of macro political conditions;
- the UK's impending departure from the EU;
- possible contraction of the UK mortgage market negatively impacting loan book growth;
- UK banks' reaction to the Bank of England unwind of the Term Funding Scheme and other liquidity schemes;
- higher unemployment and lower property prices increasing impairments;
- new conduct or legal risk provisions
- risks stemming from regulatory change for example Payments Services Directive 2 (PSD2 open banking) and other payment system requirements, increasing regulatory enforcement and an increasingly litigious environment; and
- impact on operating results, financial and capital position of the implementation of accounting standards and interpretations, including, with effect from 1 January 2018, IFRS 9 on the financial instruments classification and measurement and impairment of financial assets.

1.6.2. Regulatory deficiencies
The following section summarises the principal risks and uncertainties relating to deficiencies against regulatory requirements and expectations. The successful implementation of the Plan depends upon the ongoing support of regulators and supervising authorities regarding any continuing and intervening deficiencies to required regulatory standards.

1.6.2.1. Anticipated regulatory Capital requirements
Following the completion of the 2017 Restructuring and Recapitalisation the Group has achieved ICG and combined buffer compliance (achieved from December 2017). This is supported by improvements the Group has achieved in model risk and pension risk management. Surplus to CET1, ICG and combined buffer is expected across the life of the Plan. There is a risk that failure to keep within regulatory compliance or a change to regulatory expectations / levels could lead to deterioration of current capital positions reported.

The Plan targets MREL qualifying debt issuances across the planning horizon (2018-2022). The Bank of England has previously indicated its strong preference with regards to the profile of MREL qualifying debt issuance. There is a risk that MREL qualifying debt may need to be issued earlier than the Plan currently assumes.

1.6.2.2. Risks relating to the credit risk Capital Modelling Requirements

The Group is currently not fully compliant with the CRR provisions related to the use of an Internal Ratings Based (IRB) approach to modelling credit risk capital requirements. A review by the PRA took place during 2015 and identified areas of non-compliance and inadequate procedures relating to use of an IRB approach, requiring improvement and a remediation plan to rectify under supervisory guidance. These areas include a redesign of model risk policy, redevelopment of some of the IRB models, and the strengthening of the overall control environment. In March 2016 a formal communication was received from the PRA regarding the levying of an additional Pillar 2a requirement (model risk add-on) to cover these risks.

Significant progress has been made against these areas of non-compliance across 2017 through embedding the revised model risk policy with strengthened controls, and completing the redevelopment of several IRB models. As a result the PRA removed the model risk add on in December 2017. It is also expected a return to full compliance, subject to PRA approval, will be completed in 2018.

There is a risk that any failure to address CRR IRB non-compliance could potentially result in further regulatory action such as permission to use an IRB approach being removed or a re-imposition of a capital add-on leading to a material increase in the calculation of minimum Pillar 1 regulatory capital requirements.

1.6.2.3. Risks relating to resilience and recoverability of critical IT systems and controls

Operations are highly dependent on the proper functioning of IT and communication systems which comprise a complex array of legacy systems and some newer in-house and third party IT systems. Any significant failure to remedy the existing IT estate and operate legacy and new IT systems to meet the requirements of the strategy may adversely affect the future operational and financial performance of the business.

Although a large proportion of the critical services are now supported by technology that was migrated to new hardware in an IBM environment in the first quarter of 2017, which evidenced the return to FCA Threshold Conditions, a proportion of the current systems and technology remain on extended support arrangements or are nearing end-of-life (meaning that there is limited or no support provided by the vendor or specialist third-party supplier). There remains exposure to potential service disruptions, security weaknesses and operational inefficiencies to the legacy infrastructure and those aspects of the IT estate requiring further remediation include, but are not limited to, the desktop IT environment, loss of support of hardware and/or software and the telephony systems.

1.6.2.4. Risks relating to weaknesses in the Risk Management Framework (RMF)

Steps to enhance the RMF through the formal RMF programme were concluded during 2017. These focused on aligning roles and responsibilities between the 1st and 2nd lines of defence, updating the policy framework and the risk focussed committee structure. Work continued to drive greater consistency in the application of the RMF, including the further development of operational risk stress testing and scenario analysis using the principal risk categories, development of a Reverse Stress Testing methodology and more structured use of external operational risk loss data. Further work is required to fully embed the RMF to a consistent standard. This continues to be a key priority during 2018.

A failure to further evidence consistent application could potentially result in the PRA taking further action that may have a material adverse effect on the ability to implement the Plan.

1.6.3. Other key risks

The following pages outline the other key financial and non-financial risks to which there is exposure as identified by the RMF. Any of these risks could result in an adverse effect on the business, operating results, financial condition, reputation and prospects. Where the definition of the risk has not already been provided in section 1.4, this is provided below. The governance arrangements detailed in section 1.5 provide oversight and challenge to each of the risks documented:

Principal risk	Risk description	Key mitigating actions
Credit risk	Managing this risk is a fundamental part of what a bank does. The exposure to this risk is reducing as higher risk lending is deleveraged; however, as with all other banks, there remains an exposure to macroeconomic and market-wide risks such as issues with the housing market and interest rate changes. The Plan assumes growth in new mortgage business volumes principally through mortgage intermediaries and is consequently exposed to risks relating to the relationships with such intermediaries. As a supplier of credit to the buy-to-let sector in the UK there is a risk many borrowers in the sector have yet to operate through an entire economic cycle, and any weakness in their credit quality may impact financial and operational performance.	Credit risk is managed through a framework that sets out policies and procedures covering both its measurement and management. There is a clear segregation of duties between transaction originators and approvers in the Risk function. All credit exposure limits are approved within a defined credit approval authority framework. Credit exposures are managed through diversification across products, geographies, client and customer segments.

Pension risk	The Group is a participating employer in Pace, which has both an active defined contribution section and a closed defined benefit section and is the sponsor of the Britannia Pension Scheme (BPS), which is a closed defined benefit scheme. Pension risk exposure has significantly reduced through 2017 through active management of both Pace and BPS Significant management activity has been completed as described below: Sign off of the Implementation Agreement for Pace sectionalisation has been completed, however the agreement with Co-operative Group and the Pace Trustee on the Pace Pensions sectionalisation remains subject to a number of risks and may not be implemented on the terms currently envisaged or at all. As Pace is not yet sectionalised and continues to operate on a 'last man standing' basis there is a risk that in the event that other participating employers become insolvent and the full statutory debt is not recovered on insolvency, the Group could become liable for the remaining liabilities. Prior to sectionalisation, there is no agreed allocation of a deficit or surplus on (i) wind up of the plan; or (ii) the Group's withdrawal from the plan. The triennial valuation of BPS was completed in November 2017 and management steps are in place to actively manage the pension fund investment strategy in partnership with the BPS trustee. There is risk around macro-economic volatility in relation to scheme investments (Pace and BPS), impact to CET1, Pillar 2a requirements and resulting in a material adverse effect on the business, financial condition, operating results and prospects. There are also risks the Group's covenant weakens resulting in the requirement to post more collateral and incurring associated costs of doing so and also if the schemes return to deficit unplanned provisions could be required for future payments.	Continued assessment of CET1 and pension Pillar 2a and 2b requirements will continue as per regulatory requirements with on-going oversight from senior management. In 2018 sectionalisation of Pace is due to complete which will remove the last man standing obligation for the Group.
Operational risk (including legal risk)	Operational risk levels remain elevated due to a number of specific issues such as manual processes, legacy systems and processes for which remediation continues. These are detailed above in section 1.6.2 or are referenced below: Systems of control have been historically weak, however in 2017 significant progress has been made to meet regulatory expectations in the overall effectiveness and embeddedness of the RMF. The focus through 2018 will be to ensure robust risk and control activities remain an integral part of the business as usual activities. There is an increased awareness of the RMF and work continues to further embed all elements. Key activity includes: Further embedding of the RMF through a normalisation process and collegiate working across all three lines of defence; Ongoing oversight and completion of the Model Remediation Programme with particular emphasis on CRR and Internal Ratings Based (IRB) and IFRS 9 model development and approval; and Focus on rationalising and aligning data sources used for financial reporting. There is an increase in dependency on outsourcing contracts and partners for critical infrastructure and operational capability, often at significant expense. There is a risk that any outsourcing arrangements are not properly scoped in determining business requirements; that the Group or the supplier may default on or otherwise seek to avoid contractual requirements; that the outsourcing is not properly managed or delivered upon as expected by the outsourced provider on an ongoing basis. In addition if any of the key outsourcing partners of crucial services cannot or will not continue to provide the outsourced functions and services for a sufficient time and with provision of adequate assistance to enable transfer to an alternative provider, then the business may face significant disruption to services and functions, reputational damage and possible regulatory scrutiny, which may adversely affect the business operating results and financial condition. The process of separating from Co-operative Group continues. A number of services are provided by Co-operative Group including critical IT services, personnel, and assets. Co-operative Group may terminate certain critical IT services on twelve months' notice. The ongoing separation project is complex and costs, resource and timely execution will need to be monitored. Furthermore the replacement arrangements may be more costly than the current arrangements with Co-operative Group. The Group is engaged in various legal proceedings in the United Kingdom, involving claims both by and against it, which arise in the ordinary course of business, including (but not limited to) debt collection, mortgage enforcement, consumer claims and contractual disputes. Whilst it is not expected that the ultimate resolution of any of these known legal proceedings have a material adverse effect on the operating results, cash flows or the financial position, and whilst provisions have been recognised for those cases where the Group is able reliably to estimate the probable loss where the probable	Ongoing management, oversight and reporting in place across all three lines of defence. Litigation is managed to ensure that the financial and reputational risk to the Group is mitigated. Alternative services providers and contractual arrangements and ongoing migration of core technology.

	loss is not *de minimis*, the outcome of litigation is difficult to predict and there is a risk that such provisions will be insufficient to cover the costs associated with such litigation.	
Regulatory risk (sub set of operational risk)	Regulatory risk is defined as the risk that the Group breach the letter and spirit of relevant laws, regulations, regulatory guidance, codes of practice or standards of good market practice. Along with the wider banking industry, the Group must comply with multiple regulatory changes which may add complexity to an already difficult technology, operational and prudential change programme with key challenges potentially including changes to payments regulation (PSD2), General Data Protection Regulation (GDPR), the UK Retail Banking remedies required by the Competition and Markets Authority and changes to Anti-Money Laundering regulations. There is also a risk that changes to regulatory requirements affect the ability to successfully implement the Plan. Changes to regulatory requirements could result in additional compliance costs and diversion of management time and resources. There remains full commitment in the support of efforts to combat international and domestic funding of terrorist and criminal activity, preventing the illicit use of products and services and to meeting the legal and regulatory obligations in full. However there remains a risk that services and products may be mis-used for criminal or unlawful purposes increasing the risk of regulatory or law enforcement investigation and censure as well as reputational damage.	The complex nature of regulatory change is closely monitored by the Risk & Compliance function.
Conduct risk (sub set of operational risk)	Conduct risk is defined as the risk that behaviours, offerings or interactions will result in inappropriate outcomes for customers, the Group or its staff, if appropriate market conditions are not observed. The Plan assumes no significant new conduct or legal risk provisions during the planning horizon. There is a risk of exposure to significant new conduct or legal risks, either by discovering significant new risk issues from legacy systems and controls or from regulatory changes imposed on banks generally. There is a risk that the cost of redress, remediation and project costs may be higher than current provisions and that expected over the life of the Plan. Specifically for Payment Protection Insurance (PPI), any change in the regulators current approach, any increase in complaint volumes and any additional requirements as a result of Plevin could increase the cost of overall remediation. Inherent risks remain relating to the mis-selling of financial products, acting in breach of regulatory principles or requirements and giving negligent advice or other conduct determined by the Group or the Regulators to be inappropriate, unfair or non-compliant with applicable law or regulations. Any failure to manage these risks adequately could lead to further provisions, costs and liabilities and/or reputational damage.	Proactive remediation of known conduct issues. Management will continue to monitor current conduct and legal risk exposures to ensure appropriate provisions are allocated. Monitoring developments in product related areas that attract increased focus from regulators, the courts and the Financial Ombudsmen Service (FOS), such as early repayment charges in both commercial and secured lending and variation of certain product terms and conditions.
Fraud risk (sub set of operational risk)	Fraud risk is defined as the risk to the business or customers from individuals using deception to dishonestly make a personal gain for themselves and/or create a loss for another. As with other banks, reflecting the increased use of technology in financial services, the business and customers are at a risk of cyber-attacks including attacks designed to overload systems (e.g. Distributed Denial of Service – DDoS). These risks are accentuated as the business increasingly digitalises products, services, key functions and distribution channels and as cyber-attacks become more sophisticated and prevalent. Inherent risks remain due to increased levels of card, account, identity, internal and other frauds, some of which are more sophisticated, organised and technology-led. This growth and increased sophistication increases the fraud risk and current systems based preventative measures may be less developed than those of other banks, may not prove effective in all circumstances to prevent fraud and, without further investment, may be increasingly exposed to fraud risk from increasingly sophisticated attacks by cyber-crime groups or fraudulent activity. The Group remains fully committed to combat the risks associated with cyber-crime and fraud. Failure to implement or progress critical strategic projects to enhance fraud control and reduce the reliance on static data for customer authentication could lead to increased levels of fraud.	Strategic projects are planned during 2018 including: A pilot for behavioural biometrics in the Digital channel; Further research into the feasibility of handset or voice biometrics for the Telephone Channel; and Enhanced authentication using SMS verification for online Card Not Present transactions. Increased IT related defences deployed to detect DDoS at point of entry. Enhancements will continue to be monitored to completion. Ongoing efforts and initiatives to increase customer awareness and customer's ability to avoid fraudulent attacks.

Financial reporting risk (sub set of operational risk)	The risk of reputational damage, loss of investor confidence, increased regulatory scrutiny and/or financial loss caused by the incorrect or untimely delivery of financial reporting. IFRS 9 Financial Instruments is a significant new accounting standard effective from 1 January 2018. Applying the new classification and measurement principles and calculating expected credit losses is operationally complex. There is a risk that implementing IFRS 9 within the required timelines has a detrimental impact on the timeliness and accuracy of financial reporting. Significant progress has been made to reduce and mitigate financial reporting risk, through enhanced systems, process and reconciliation controls. Remaining risks are monitored and managed through the RMF, and focus continues in 2018 on rationalising data sources and IT systems and further enhancing the regulatory reporting control framework.	Close and detailed monitoring of the IFRS 9 delivery plan including oversight by Audit Committee. Testing of IFRS 9 key controls, processes and reporting. Parallel run and analysis of the expected impact. Continued oversight of financial reporting improvements.
Information and data risk (sub set of operational risk)	Information and data risk is associated with theft, loss, or misuse of information and data or the processing of poor quality information and data, resulting in customer or financial detriment, and legal or regulatory censure. Information and data risk is a sub set of operational risk. There are weaknesses in the framework for managing data, including adequate business and IT infrastructure, documented standards on ownership and quality of data (relating to customers and employees as well as proprietary data), as well as clear, documented standards and policies about the use of data. Failure to adequately maintain corporate records or to adequately maintain and protect customer and employee information could have a material adverse effect on the Group. Weaknesses in the data governance and data ownership framework have led to sub-optimal data management practices being adopted. These practices have resulted in difficulties in verifying the quality and usage of data. As a result, there are risks of inaccurate or incomplete financial and other reporting as well as the risk of inappropriate decision-making due to errors in underlying data. There are also increased requirements to comply with under GDPR and increased focus by the Information Commissioners Office (ICO) on internal management and control of data which leads to the risk of non-compliance with regulations and reputational exposure.	In 2017 a refreshed framework for managing information and data, including the policy and control standard were approved and are to be implemented through 2018 with oversight provided by the Information and data risk Governance Forum and the Operational Risk Oversight Committee.
People risk (sub set of operational risk)	People risk is defined as the risk associated with inappropriate employee behaviour, inadequate resource (people, capability and frameworks), resulting in customer or financial detriment, and/or legal or regulatory censure. Retention of personnel remains a significant risk and has been heightened by the inability to use variable pay to reward performance, budgetary constraints limiting changes to fixed pay, scale and complexity of change, headcount reductions and ongoing pressure on cost reduction. Employee confidence and engagement levels increased in 2017, with the engagement score now above the UK Retail banking industry benchmark. However, staff retention and engagement will continue be a significant challenge for the Executive team. A number of key initiatives continued during 2017 to tackle some key issues relating to people risk. The culture programme sought to improve colleague engagement, reinforcing the values and culture and embedding these into employee policies and processes. The emerging talent strategy further advanced in 2017 with the continuation of the summer internship programme, apprenticeships and the graduate scheme. Considerable progress in strengthening the talent profile and senior level succession planning has been made during 2017, although ongoing structural changes will impact on succession strength. If Senior Executives or management leave earlier than planned, the Group may struggle to replace them with appropriate and sufficiently skilled candidates in a timely fashion, exposing the Group to operational disruption and potential delay in essential activities necessary for the Plan to be successfully delivered.	Considerable progress during 2017 has been made in strengthening the talent profile and senior level succession plans. However ongoing structural change will impact on succession strength, therefore planning for key critical roles will remain a focus in 2018. Employee turnover levels and employee engagement improved significantly during the second half of 2017 but will continue to be monitored, particularly in relation to resignations from high performing colleagues.
Liquidity and funding risk	There are inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as Retail deposits becomes limited and/or becomes more expensive and if liquidity cannot be deployed as required. This may have an adverse effect on business, profitability and the ability to meet liabilities as they fall due. Risks associated with wholesale market access and volatility are also faced.	The liquidity position is well managed and the experience of previous stress events allows a good understanding of the real impact of a stress event on the liquidity positions. The Liquidity Risk Appetite and Liquidity Coverage Ratio thresholds are met throughout the plan with the exception of a small breach relating to the roll off of the covered bond maturity.

1.7 Emerging risks

Emerging risk	Definition/commentary	Key mitigating actions
Regulatory risk	Tight regulatory compliance deadlines have the potential to result in regulatory change programmes not meeting such deadlines, or to constrain time available for implementing strategic solutions.	Close ongoing monitoring of the regulatory portfolio through BResCo and associated Steering Committees ensuring the mobilisation of regulatory change is timely and effective and takes in to account the narrowing of the time gap between consultation and finalisation of rules by both the PRA and FCA.
Reputational risk	The Group considers that its reputation as an ethically led organisation is critical to the success of the Plan and actively seeks to manage and mitigate the risks that may impact its reputation. The Group and Bank continues to use the Co-operative name. The Co-operative Bank trademark belongs to the Bank, however in certain circumstances the right to use the term 'co-operative' could be challenged or removed. There is also a risk that its brand may be damaged as a result of matters affecting other co-operatives.	The Group seeks to protect its reputation and brand territory through consensual discussions and legal means where necessary. The Group continues to liaise with Co-operative Group regarding trademarks and intellectual property. The Group also seeks to maintain an active dialogue with key stakeholders including Co-operatives UK and makes an active contribution to the co-operative movement.

1.8 Risk profile of the Bank

This table shows the business activities of each of the divisions of the Bank and the RWAs which reside in each division:

Retail	**Business activities:** • Deposits • Credits and lending to Retail	**Loans and advances to customers (£m)** 14,711.0	**RWAs (£m)** Credit risk: 1,949.0 Operational risk: 486.1
Optimum	**Business activities:** • Closed residential mortgage book	**Loans and advances to customers (£m)** 585.7	**RWAs (£m)** Credit risk: 335.8 Operational risk: (21.3)[2]
BaCB	**Business activities**: • Lending to SME sector • Deposits to the SME sector	**Loans and advances to customers (£m)** 313.1	**RWAs (£m)** Credit risk: 372.7 Operational risk: 159.6
Legacy Portfolio	**Business activities:** • Historic corporate loans	**Loans and advances to customers (£m)** 1,134.7	**RWAs (£m)** Credit risk: 870.2 Operational risk: (19.3)[2]
Treasury and Other	**Business activities:** • Cash flow, liquidity management, FX	**Credit risk balances (£m)** 3,194.9[1]	**RWAs (£m)** Credit risk: 921.9 Operational risk: 30.9

1. Combination of Loans and advances to Banks, Investment securities and Derivative financial instruments.
2. The capital requirement for operational risk is calculated using three prior years operating income; Legacy & Optimum income has been negative resulting in a negative calculation of RWA. CRR allows for positive income values in business line activity to be offset by negative income providing the overall total is not less than zero.

2. Capital risk

Overview - Unaudited

Capital resources are held to protect depositors, to cover inherent risks, to absorb unexpected losses, and to support the development of the business.

Capital adequacy is managed and calculated in accordance with CRD IV, implemented in the European Union through publication of CRR and a further iteration of the Capital Requirements Directive (CRD). Together this package of requirements is known as CRD IV and came into force from 1 January 2014. The European Banking Authority is providing technical standards relating to CRD IV, some of which are not yet finalised. CRD IV disclosures in this and related documents are based on the Bank's interpretation of published rules.

Implementation of IFRS 9

The adoption of IFRS 9 on 1 January 2018 is estimated to reduce total equity by £7m to £15m, net of deferred tax. Further explanation of the expected impact of the implementation of IFRS 9 is provided in note 1.1.2 to the consolidated financial statements. We do not expect the transition to IFRS 9 to have a significant impact on our regulatory capital position. The Bank has elected to apply the regulatory transitional arrangements in relation to the impairment requirements of IFRS 9.

The Detailed Financial Report and the 2017 Pillar 3 (Section 3 Capital Adequacy) report provide further detail on the Capital risk in terms of:

- adequacy (including key capital highlights);
- stress testing;
- buffers;
- total resources;
- movement in resources;
- reconciliation to the balance sheet;
- Pillar 1 and RWA;
- RWA flows;
- reconciliation of balance sheet to credit risk exposure to Exposure at Default; and
- common leverage rate disclosures.

3. Credit risk

3.1 Overview and credit exposure

Credit risk is managed through a framework that sets out policies and procedures covering both its measurement and management. There is a clear segregation of duties between transaction originators in the businesses and approvers in the Risk function. All credit exposure limits are approved within a defined credit approval authority framework. Credit exposures are managed through diversification across products, geographies (UK), clients and customer segments.

The following analysis of credit exposure shows:

- carrying amounts by class of asset in the balance sheet;
- the gross credit exposure by class of asset (excluding allowance for losses but including credit commitments); and
- the net credit exposure by class of asset (including allowance for losses and credit commitments).

Cash and balances at central banks are credit exposures with the Bank of England and have been excluded from the analysis. Impaired and not impaired balances in the tables below are defined in the following sections on Retail credit risk, Corporate credit risk and investment securities credit risk.

All amounts are stated in £m unless otherwise indicated. All comparatives are 31 December 2016 unless otherwise stated.

Audited

	Group and Bank				
2017	**Loans and advances to banks**	**Loans and advances to customers**	**Investment securities**	**Derivative financial instruments**	**Total**
Analysis of balance in notes	13	14	15a,b,c	16	
Gross balance	**574.8**	**16,824.5**	**2,387.7**	**232.4**	**20,019.4**
Less: allowance for losses	**-**	**(80.0)**	**-**	**-**	**(80.0)**
	574.8	**16,744.5**	**2,387.7**	**232.4**	**19,939.4**
Analysis of credit risk exposure					
Not impaired	**574.8**	**16,427.6**	**2,387.7**	**232.4**	**19,622.5**
Impaired	**-**	**396.9**	**-**	**-**	**396.9**
	574.8	**16,824.5**	**2,387.7**	**232.4**	**20,019.4**
Credit commitments (incl. Derivative and Contingent Liabilities)	**-**	**2,411.0**	**-**	**-**	**2,411.0**
Gross credit risk exposure	**574.8**	**19,235.5**	**2,387.7**	**232.4**	**22,430.4**
Less: allowance for losses	**-**	**(80.0)**	**-**	**-**	**(80.0)**
Net credit risk exposure	**574.8**	**19,155.5**	**2,387.7**	**232.4**	**22,350.4**

	Group and Bank				
Restated[1] & Re-presented[2] 2016	Loans and advances to banks	Loans and advances to customers	Investment securities	Derivative financial instruments	Total
Analysis of balance in notes	13	14	15a,b,c	16	
Gross balance	658.3	19,575.0	3,551.9	425.5	24,210.7
Less: allowance for losses	-	(122.3)	-	-	(122.3)
	658.3	19,452.7	3,551.9	425.5	24,088.4
Analysis of credit risk exposure					
Not impaired	658.3	18,871.5	3,551.9	425.5	23,507.2
Impaired	-	703.5	-	-	703.5
	658.3	19,575.0	3,551.9	425.5	24,210.7
Credit commitments (incl. Derivative and Contingent Liabilities)	-	2,441.7	-	-	2,441.7
Gross credit risk exposure	658.3	22,016.7	3,551.9	425.5	26,652.4
Less: allowance for losses	-	(122.3)	-	-	(122.3)
Net credit risk exposure	658.3	21,894.4	3,551.9	425.5	26,530.1

1. The above table has been restated to show an updated split between not impaired and impaired assets for the Loans and advances to customers (as reported in the 2017 Interim Accounts). See the Loans and advances to customers summary table for further detail.
2. The figures in the above table have been re-presented to more fairly reflect their nature. Further information can be found in notes 13 and 22 to the consolidated financial statements.

3.2 Credit risk management

The following sections provide further analysis and disclosure of the Bank's credit risk associated with:

3.2.1 Loans and advances to customers;
3.2.2 Investment securities;
3.2.3 Loans and advances to banks;
3.2.4 Derivative financial instruments; and
3.2.5 Wholesale credit risk.

3.2.1 Loans and advances to customers

The tables below analyse gross customer balances by impairment classification. Balances include credit commitments, impairment provisions, fair value adjustments and a reconciliation to gross customer balances. This is the basis on which risk is managed. The disclosures in the sections Secured residential mortgage credit risk, Unsecured Retail credit risk and Corporate credit risk are all based on the gross customer balances in the below tables (unless otherwise noted).

Customer exposures are predominantly within the UK and so any geographic analysis is only UK based. At 31 December 2017 the amount of overseas exposure is £56.1m (2016: £95.0m), split across Corporate (£26.8m) and Unsecured (£29.3m). This represents 0.3% (2016: 0.4%) of the total credit risk exposure.

Other accounting adjustments include accrued interest, fair value adjustments, effective interest rate adjustments and for 2016 Britannia merger fair value adjustments (including Lifetime Expected Losses). In 2017 the remaining fair value adjustments relating to the merger were all unwound as the values had become immaterial.

Audited

	Group and Bank					
	Secured residential			Corporate		
2017	**Retail secured**	**Optimum**	**Retail unsecured**	**BaCB**	**Legacy Portfolio**	**Total**
Analysis of balance in note 14						
Gross loans and advances	**14,159.8**	**593.7**	**592.3**	**313.8**	**1,164.9**	**16,824.5**
Less: allowance for losses	**(10.5)**	**(8.0)**	**(30.6)**	**(0.7)**	**(30.2)**	**(80.0)**
	14,149.3	**585.7**	**561.7**	**313.1**	**1,134.7**	**16,744.5**
Analysis of credit risk exposure						
Not impaired	**14,024.0**	**484.4**	**549.2**	**301.0**	**1,069.0**	**16,427.6**
Impaired	**135.8**	**109.3**	**43.1**	**12.8**	**95.9**	**396.9**
	14,159.8	**593.7**	**592.3**	**313.8**	**1,164.9**	**16,824.5**
Credit commitments (incl. Cont. Liab. & Derivatives)	**697.3**	**-**	**1,437.6**	**100.5**	**175.6**	**2,411.0**
Gross credit risk exposure	**14,857.1**	**593.7**	**2,029.9**	**414.3**	**1,340.5**	**19,235.5**
Less: allowance for losses	**(10.5)**	**(8.0)**	**(30.6)**	**(0.7)**	**(30.2)**	**(80.0)**
Net credit risk exposure	**14,846.6**	**585.7**	**1,999.3**	**413.6**	**1,310.3**	**19,155.5**
Reconciliation of accounting to customer balances						
Gross loans and advances	**14,159.8**	**593.7**	**592.3**	**313.8**	**1,164.9**	**16,824.5**
Accounting adjustments	**(56.5)**	**(0.1)**	**(9.0)**	**(10.2)**	**(29.2)**	**(105.0)**
Gross customer balances	**14,103.3**	**593.6**	**583.3**	**303.6**	**1,135.7**	**16,719.5**

Restated[1] 2016	Group and Bank					
	Secured residential			Corporate		
	Retail secured	Optimum	Retail unsecured	BaCB	Legacy Portfolio	Total
Analysis of balance in note 14						
Gross loans and advances	14,215.1	2,618.3	710.0	499.0	1,532.6	19,575.0
Less: allowance for losses	(3.7)	(12.5)	(57.6)	(1.0)	(47.5)	(122.3)
	14,211.4	2,605.8	652.4	498.0	1,485.1	19,452.7
Analysis of credit risk exposure						
Not impaired	14,045.1	2,321.8	638.6	469.6	1,396.4	18,871.5
Impaired	170.0	296.5	71.4	29.4	136.2	703.5
	14,215.1	2,618.3	710.0	499.0	1,532.6	19,575.0
Credit commitments (incl. Cont. Liab. & Derivatives)	459.9	-	1,621.8	142.7	217.3	2,441.7
Gross credit risk exposure	14,675.0	2,618.3	2,331.8	641.7	1,749.9	22,016.7
Less: Allowance for losses	(3.7)	(12.5)	(57.6)	(1.0)	(47.5)	(122.3)
Net credit risk exposure	14,671.3	2,605.8	2,274.2	640.7	1,702.4	21,894.4
Reconciliation of accounting to customer balances						
Gross loans and advances	14,215.1	2,618.3	710.0	499.0	1,532.6	19,575.0
Accounting adjustments	(77.6)	17.1	(12.9)	(36.0)	(23.4)	(132.8)
Gross customer balances	14,137.5	2,635.4	697.1	463.0	1,509.2	19,442.2

1. The above table has been restated to show an updated split between not impaired and impaired assets to reflect the change in the secured residential forbearance definition (as reported in the 2017 Interim Accounts). This update has also impacted subsequent tables where the not impaired/impaired split is used.

Secured residential mortgage credit risk
The secured residential mortgage book comprises two portfolios:

Retail Secured – these are a mix of prime and buy to let (BTL) mortgages. All new completions are in this portfolio (see Acquisition and account management for details).
Optimum – a closed book of predominantly interest only intermediary and acquired residential mortgage books. These loans include a range of asset types, including prime residential (both income verified and self-certified), buy to let and non-conforming mortgages. The book was closed in 2009 and has seen the book size reduce to £0.6bn from a combination of run off and a series of securitisations under the Warwick name. The last securitisation was in October 2017, resulting in the significant decrease in Optimum balances from year end 2016 to year end 2017.

Unless stated otherwise all analysis is based on Gross customer balances.

Acquisition and account management
Mortgages are loans to customers secured by a first charge over a residential property. Mortgages are originated directly to customers via branches, telephone and the internet under the Britannia and The Co-operative Bank brands, and via intermediaries under the Platform brand. In 2018 the Bank will cease to offer new direct business via the telephone and in branches. Of the mortgage completions including ports in the year to 31 December 2017, 5.4% (2016:12.5%) were directly originated and 94.6% (2016:87.5%) were originated through intermediaries.

The Britannia and The Co-operative Bank brands only originate prime residential mortgages, while Platform currently originates a combination of prime residential mortgages and buy to let loans. Historically, these loans have been advanced on a capital and interest payment basis, where the loan is repaid over the term of the loan, or interest only, where the capital element of the loan is repayable at the end of the term. All new advances are on a capital repayment basis, with the exception of buy-to-let lending and existing interest only loans for customers moving home.

During the term of the mortgage, interest only mortgages are managed consistently with capital and repayment mortgages. In addition, the Bank determines if the customer has a satisfactory repayment strategy in place on loan maturity, in line with our customer contact strategy.

The table below shows residential mortgage completions in the period (including cases where customers have ported their mortgage from one property to another), analysed by loan-to-value (LTV) and repayment method.

Unaudited

	Group and Bank					
	2017			2016		
	Amount advanced	**Average LTV %**	**Interest only %**	Amount advanced	Average LTV %	Interest only %
Britannia & Co-operative prime	**181.5**	**56.0**	**2.2**	396.9	60.2	0.7
Platform prime	**3,010.2**	**69.2**	**-**	2,347.2	69.1	-
Total prime	**3,191.7**	**68.3**	**0.1**	2,744.1	67.8	0.1
Buy-to-let	**174.8**	**61.5**	**84.0**	439.6	65.1	91.7
Total completions (including ports)	**3,366.5**	**67.7**	**4.5**	3,183.7	67.4	12.7

Retail secured completions have remained broadly stable and driven predominantly through Platform prime lending.

Risk in the portfolio is recalculated monthly, using internally developed behavioural models. A regional house price index is used to reflect any changes in the value of collateral updated on a quarterly basis. This process is also used to determine the amount of capital which is required to be held for individual loans.

Portfolio analysis

The following tables show the Retail and Optimum total customer balances by a number of key risk measurements. Overall, the Secured Residential has seen a reduction in Gross Loans and Advances by £2.1bn, mainly driven by the impact of Warwick Finance Three on the Optimum book. This has seen a reduction in the average LTV on the Optimum book and a significant reduction in the interest only balances.

Gross customer balances split by indexed LTV bandings are shown below (with interest only including mortgages on a part repayment /part interest basis):

Audited

2017	**Group and Bank**				
	Retail secured		**Optimum**		
LTV %	**Capital repayment**	**Interest only**	**Capital repayment**	**Interest only**	**Total**
Less than 50%	**4,460.2**	**1,438.4**	**59.6**	**178.3**	**6,136.5**
50% to 60%	**1,763.5**	**574.2**	**10.2**	**116.0**	**2,463.9**
60% to 70%	**2,076.4**	**504.8**	**4.1**	**102.5**	**2,687.8**
70% to 80%	**1,853.2**	**121.7**	**2.3**	**79.2**	**2,056.4**
80% to 90%	**1,168.2**	**36.9**	**0.5**	**26.3**	**1,231.9**
90% to 100%	**84.6**	**11.8**	**0.2**	**7.7**	**104.3**
Greater than 100%	**1.5**	**7.9**	**-**	**6.7**	**16.1**
	11,407.6	**2,695.7**	**76.9**	**516.7**	**14,696.9**

2016	Group and Bank				
	Retail secured		Optimum		
LTV %	Capital repayment	Interest only	Capital repayment	Interest only	Total
Less than 50%	4,773.2	1,641.1	177.0	389.6	6,980.9
50% to 60%	1,776.5	660.4	76.3	465.8	2,979.0
60% to 70%	1,923.0	599.9	70.8	475.0	3,068.7
70% to 80%	1,563.6	195.8	37.5	439.0	2,235.9
80% to 90%	829.5	58.0	8.5	312.8	1,208.8
90% to 100%	79.3	25.4	1.2	137.9	243.8
Greater than 100%	3.1	8.7	0.7	43.3	55.8
	10,948.2	3,189.3	372.0	2,263.4	16,772.9

Interest only balances are contractually due to mature as shown below:

Unaudited

2017	**Group and Bank**					
	< 1 year	**1-5 years**	**5-10 years**	**10-20 years**	**20+ years**	**Total**
Retail secured	**116.0**	**320.7**	**570.5**	**1,221.4**	**467.1**	**2,695.7**
Optimum	**43.8**	**54.0**	**117.0**	**300.0**	**1.9**	**516.7**
	159.8	**374.7**	**687.5**	**1,521.4**	**469.0**	**3,212.4**

2016	Group and Bank					
	< 1 year	1-5 years	5-10 years	10-20 years	20+ years	Total
Retail secured	118.9	363.7	655.4	1,449.8	601.5	3,189.3
Optimum	57.1	165.2	377.6	1,597.4	66.1	2,263.4
	176.0	528.9	1,033.0	3,047.2	667.6	5,452.7

Total interest only balances have reduced by 41.1% during the year, driven by Warwick Finance Three with a shift in LTV distribution largely due to improvements in HPI. Other Retail balances have grown, driven by new completions through Platform.

The proportion of total Retail secured balances with current LTV less than 50% has fallen slightly in the year to 31 December 2017 to 41.8% (2016: 45.4%), driven largely by an increase in higher LTV lending via Platform.

The table below shows gross customer balances for residential mortgages analysed by asset class, the LTV shown is the current indexed average percentage:

Unaudited

2017	**Group and Bank**					
	Retail secured			**Optimum**		
	Gross customer balance	**Average LTV %**	**Interest only %**	**Gross customer balance**	**Average LTV %**	**Interest only %**
Prime residential	**12,885.9**	**52.6**	**12.6**	**37.5**	**54.9**	**81.7**
Buy-to-let	**1,149.3**	**56.0**	**89.4**	**140.0**	**52.0**	**91.2**
Self-certified	**45.4**	**36.6**	**89.5**	**225.4**	**52.2**	**92.7**
Almost prime	**21.8**	**38.8**	**34.5**	**46.5**	**68.3**	**86.0**
Non-conforming	**0.9**	**53.0**	**55.4**	**144.2**	**53.4**	**75.9**
	14,103.3	**52.8**	**19.1**	**593.6**	**53.9**	**87.0**

2016	Group and Bank					
	Retail secured			Optimum		
	Gross customer balance	Average LTV %	Interest only %	Gross customer balance	Average LTV %	Interest only %
Prime residential	12,802.8	50.5	15.7	172.1	66.2	84.6
Buy-to-let	1,254.3	57.2	89.8	903.7	62.0	94.8
Self-certified	52.7	38.3	88.2	759.7	62.2	87.2
Almost prime	26.5	40.9	32.7	422.6	73.2	78.2
Non-conforming	1.2	52.4	47.7	377.3	59.8	71.2
	14,137.5	51.1	22.6	2,635.4	63.8	85.9

The table below show gross customer balances analysed by geographical location:

Audited

	Group and Bank			
	2017		2016	
	Retail secured	**Optimum**	Retail secured	Optimum
London & South East	**6,126.5**	**292.5**	6,173.4	1,182.8
Northern England	**2,801.8**	**117.2**	2,750.8	590.4
Midlands & East Anglia	**2,834.9**	**96.0**	2,866.3	423.8
Wales & South West	**1,617.4**	**62.7**	1,657.6	262.3
Other	**722.7**	**25.2**	689.4	176.1
Total	**14,103.3**	**593.6**	14,137.5	2,635.4

Lending in London and South East accounts for 43.4% of overall lending (excluding Optimum), remaining stable since 2016 (2016: 43.7%).

Collateral

Mortgages are secured by a first charge over the property being purchased or remortgaged. Valuation of the property is normally assessed by a Royal Institution of Chartered Surveyors (RICS) certified surveyor from the Bank's approved panel but valuations may also be assessed through the use of an automated valuation model (AVM).

The Bank reassesses the valuation of collateral for the non-default book on a quarterly basis using a regional property price index. The table below analyses the indexed value of property collateral held against mortgage portfolios:

Audited

2017	**Group and Bank**					
	Retail secured			**Optimum**		
	Gross customer balance	**Collateral**	**Cover %**	**Gross customer balance**	**Collateral**	**Cover %**
Impaired	**135.8**	**135.7**	**99.9**	**109.3**	**108.7**	**99.5**
Not impaired	**13,967.5**	**13,964.7**	**100.0**	**484.3**	**484.0**	**99.9**
	14,103.3	**14,100.4**	**100.0**	**593.6**	**592.7**	**99.8**

2016	Group and Bank					
	Retail secured			Optimum		
	Gross customer balance	Collateral	Cover %	Gross customer balance	Collateral	Cover %
Impaired	170.0	169.7	99.8	296.5	294.6	99.4
Not impaired	13,967.5	13,964.6	100.0	2,338.9	2,335.9	99.9
	14,137.5	14,134.3	100.0	2,635.4	2,630.5	99.8

In the table, collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank. For the purposes of determining capital and impairment, appropriate forced sale discount assumptions are applied to collateral.

Impairment

Where objective evidence of impairment has been observed as a result of one or more loss events, the impairment held at the balance sheet date is defined as identified impairment.

Loans under forbearance are subject to a specific identified impairment assessment. Loans where no objective evidence has been observed are collectively assessed for unidentified impairment (i.e. where a loss event has occurred, but objective evidence of impairment has not yet been identified).

The table shown below reports coverage ratios calculated using:
- carrying values in the accounts; and
- impaired balances defined as one or more payments past due, forborne or in default (6+ months past due, possession, litigation, bankruptcy or Law of Property Act (LPA) receiver appointed).

Audited

	Group and Bank			
	2017		Restated 2016	
	Retail secured	**Optimum**	Retail secured	Optimum
Gross loans and advances	**14,159.8**	**593.7**	14,215.1	2,618.3
of which impaired	**135.8**	**109.3**	170.0	296.5
Impaired as a % of gross loans and advances	**1.0%**	**18.4%**	1.2%	11.3%
Allowance for losses	**10.5**	**8.0**	3.7	12.5
Coverage - impaired assets	**7.7%**	**7.3%**	2.2%	4.2%
Coverage - total book	**0.07%**	**1.35%**	0.03%	0.48%

Retail impaired balances reduced in the period by £34.2m (20.1%), largely driven by a reduction in arrears. An increase in new Platform lending, coupled with a reduction in total impaired balances, leads to the proportion of impaired balances reducing from 1.2% to 1.0%. In spite of the reduction in impaired balances, allowance for losses increased to £10.5m (183.8%) in the period to reflect the growth in the Platform portfolio (higher average LTV's – see acquisition and account management table) and increase in coverage associated with interest only mortgages.

Optimum impaired balances reduced in the period by £187.2m (63.1%), of which £151.0m was driven by Warwick Finance Three. The exclusion of certain impaired segments, such as term expired, from Warwick Finance Three results in an increase in the proportion of impaired balances in the Optimum portfolio to 18.4% at 31 December 2017 (2016: 11.3%). Allowance for losses reduced in the year as a result of provision releases associated with the securitisation (£3.0m) and other net movements (£4.8m) including write-offs, which was offset by a write-off of merger fair value (£3.3m).

- the Retail 90+ days past due and default balance is £35.2m (2016: £49.2m), 0.2% of total customer balances (2016: 0.3%); and
- the Optimum 90+ days past due and default balance is £44.7m (2016: £139.0m), 7.5% of total customer balances (2016: 5.3%).

The movements in impaired gross customer balances during the year are shown below:

Audited

	Group and Bank			
	2017		Restated 2016	
	Retail secured	**Optimum**	Retail secured	Optimum
Balance at start of the year	**170.0**	**296.5**	194.7	318.4
Classified as impaired during the year	**49.5**	**29.8**	71.7	102.0
Transferred to unimpaired during the year	**(42.7)**	**(24.1)**	(24.0)	(59.2)
Net repayments and other	**(41.0)**	**(192.9)**	(72.4)	(64.7)
Balance at the end of the year	**135.8**	**109.3**	170.0	296.5

Optimum Net Repayments includes £151.0m reduction in impaired customer balances due to Warwick Finance Three.

The table below shows the credit quality of customer balances that are not impaired:

Unaudited

	Group and Bank					
	2017			Restated 2016		
	Retail secured	**Optimum**	**Total**	Retail secured	Optimum	Total
Low to medium risk	**13,594.0**	**370.7**	**13,964.7**	13,611.0	1,841.4	15,452.4
Medium to high risk	**373. 5**	**113.6**	**487.1**	356.5	497.5	854.0
	13,967.5	**484.3**	**14,451.8**	13,967.5	2,338.9	16,306.4

Low to medium risk is defined as exposures with a probability of default (PD) in the next year of 1% or below. Medium to high risk is defined as exposures with a PD in the next year of greater than 1%. All PDs are calculated using the internal ratings based (IRB) approach under CRD IV. An increase in the Retail secured medium to high risk unimpaired exposures is largely driven by the increase in higher LTV lending in the Platform portfolio.

Modelling of credit risk impairment is subject to a number of sensitivities including:
- change in the indexed collateral value;
- change in the forced sale discount applied; and
- assumptions around discount rate and period.

Changes to the above parameters can have a significant impact on the impairment provision.

Forbearance
Forbearance occurs when, for reasons relating to actual or apparent financial difficulty of the borrower, a temporary or permanent concession is granted. A concession may involve short term restructuring of the payment terms of the loan or an extension of the maturity date. The primary aim of forbearance is to help the borrower through a period of financial difficulty and return the account into a sustainable position where the facility can be serviced through to full repayment. Where the primary aim cannot be achieved, the secondary aim is to maximise recovery of debt.

A number of forbearance options, including concessionary arrangements, are available to borrowers in financial difficulty. These are handled either with customers directly or through a third party whom they have chosen to represent them. Accounts classified as forborne remain so until the period of financial difficulty has passed and the account has demonstrated it can operate under sustainable terms.

The table below analyses secured residential mortgage balances by type of forbearance and the associated gross impairment coverage (including credit fair value adjustments):

Unaudited

	Group and Bank							
	2017				Restated 2016[1]			
Retail secured	**Non arrears**	**In arrears or defaulted**	**Total**	**Impairment coverage**	Non arrears	In arrears or defaulted	Total	Impairment coverage
Concessions	**2.5**	**3.2**	**5.7**	**-**	2.4	4.9	7.3	0.1
Arrangements	**6.9**	**12.1**	**19.0**	**0.1**	6.2	13.3	19.5	0.2
Term extensions	**0.3**	**0.2**	**0.5**	**-**	0.3	0.1	0.4	-
Assisted Voluntary Sale	**-**	**-**	**-**	**-**	-	0.1	0.1	-
Interest only switches	**1.7**	**-**	**1.7**	**-**	1.6	0.7	2.3	-
Capitalisations	**-**	**-**	**-**	**-**	0.1	-	0.1	-
Term expired	**48.4**	**3.1**	**51.5**	**0.1**	52.0	4.2	56.2	0.2
Payment holiday	**6.8**	**0.8**	**7.6**	**-**	12.5	1.7	14.2	-
Deceased grace period	**1.1**	**1.3**	**2.4**	**0.1**	0.7	1.0	1.7	-
	67.7	**20.7**	**88.4**	**0.3**	75.8	26.0	101.8	0.5

	Group and Bank							
	2017				Restated 2016[1]			
Optimum	**Non arrears**	**In arrears or defaulted**	**Total**	**Impairment coverage**	Non arrears	In arrears or defaulted	Total	Impairment coverage
Concessions	**0.1**	**1.3**	**1.4**	**-**	1.2	5.9	7.1	0.1
Arrangements	**6.0**	**25.5**	**31.5**	**1.9**	16.3	77.4	93.7	4.7
Term extensions	**-**	**-**	**-**	**-**	-	0.1	0.1	-
Assisted Voluntary Sale	**-**	**-**	**-**	**-**	-	-	-	-
Interest only switches	**-**	**-**	**-**	**-**	0.2	0.6	0.8	-
Capitalisations	**-**	**-**	**-**	**-**	-	0.2	0.2	-
Term expired	**33.2**	**3.8**	**37.0**	**0.5**	29.7	5.7	35.4	1.6
Payment holiday	**0.2**	**-**	**0.2**	**-**	2.4	0.4	2.8	-
Deceased grace period	**0.1**	**0.6**	**0.7**	**-**	1.8	0.1	1.9	-
	39.6	**31.2**	**70.8**	**2.4**	51.6	90.4	142.0	6.4

1. The above table has been restated to show an updated split between not impaired and impaired assets to reflect the change in the secured residential forbearance definition (as reported in the 2017 Interim Accounts).

Retail balances subject to forbearance have displayed a reduction of £13.4m since 2016. The reduction has been spread across the treatments.

Optimum forbearance has reduced by 50.1% mainly as a result of the recent Warwick Finance Three.

Unsecured Retail credit risk
The unsecured book comprises balances for personal loans, professional and career development loans, credit cards and overdrafts.

Unless stated otherwise all analysis is based on Gross customer balances (for drawn balances) or Gross customer balances plus credit commitments (for exposure balances).

Acquisition and account management
The Bank offers unsecured lending through loans, credit cards and overdrafts. Customers' applications for credit are assessed using a combination of credit scoring and policy rules. Credit cards and overdrafts are subject to ongoing account management to determine any increase or decrease in credit limit that should apply as well as to manage over limit authorisations.

The portfolio risk is reassessed monthly using behavioural scorecards to determine the amount of capital required to be held for individual exposures.

The following table shows unsecured lending gross customer balances (including undrawn commitments) by product type:

Unaudited

	Group and Bank	
	2017	2016
Loans	**132.5**	180.6
Professional and career development loans	**66.1**	65.0
Credit cards	**1,569.7**	1,790.6
Overdrafts	**252.6**	282.7
	2,020.9	2,318.9

Total unsecured balances, including undrawn commitments have reduced by 12.9% during the period. Loan balances have reduced by 26.6% due to asset amortisation and low volumes of new business during 2017. Credit card exposure has reduced by 12.3% driven primarily by customer management limit strategies along with a reduction in customer balances.

Impairment
An impairment provision is recognised for the following categories:

- identified impairment - one day or more past due, forborne or in default (6+ months past due, bankruptcy or charged-off); and
- unidentified impairment - on the performing book, based on the probability of the emergence of delinquencies, the probability of default and the discounted cash flow of recoveries from default.

Coverage ratios calculated using carrying values in the accounts are shown in the table below:

Audited

	Group and Bank	
	2017	2016
Gross loans and advances	**592.3**	710.0
of which impaired	**43.1**	71.4
Impaired as a % of gross loans and advances	**7.3%**	10.1%
Allowance for losses	**30.6**	57.6
Coverage – impaired assets	**71.0%**	80.7%
Coverage – total book	**5.17%**	8.11%

A reduction of £117.7m (16.6%) in gross loans and advances in the year to 31 December 2017 is driven by asset amortisation, low volumes of new business and the sale of £19.9m of impaired credit card and overdraft balances. The proportion of impaired loans has reduced from 10.1% to 7.3% driven largely by the aforementioned debt sales and as a result provision coverage has reduced from 8.1% to 5.2%.

The movements in impaired gross customer balances during the year are shown below:

	Group and Bank	
	2017	2016
Balance at start of year	**71.4**	126.8
Classified as impaired during the year	**15.0**	20.8
Transferred to unimpaired during the year	**(6.7)**	(7.2)
Bulk debt sale during the year	**(19.9)**	(45.1)
Other write off during the year	**(15.5)**	(7.0)
Other repayments during the year	**(1.2)**	(16.9)
Balance at end of year	**43.1**	71.4

Corporate credit risk
The Corporate book is managed within two portfolios:

- Business and Commercial Banking (BaCB) – this segment specialises in lending to small businesses, including charities.
- Legacy portfolio – this is a closed portfolio of corporate assets which are inconsistent with the current business strategy and risk appetite. The portfolio has been actively deleveraged over a number of years which has significantly reduced the exposure, particularly in the higher risk Commercial Real Estate (CRE) sector. The main elements of the book are now in the lower risk sectors of Housing Association and PFIs.

Unless stated otherwise all analysis is based on Gross customer balances (for drawn balances) or Gross customer balances plus credit commitments (for exposure balances).

Acquisition and account management
The lending criteria requires borrowers to meet criteria as laid down in individual sector strategy guidelines and operates a strict policy with regards to single name and sector concentrations. Currently there is a limited appetite for new Corporate lending.

BaCB
The majority of BaCB rated customers are rated as strong or good (70.9%), with 24.8% rated via the standardised approach. The BaCB portfolio represents a number of industry sectors with largest concentrations evident in Property and Construction (27.6%) and Retail and Wholesale (17.3%).

The tables below show the distribution of the BaCB customer balances (including commitments) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories.

Unaudited

2017	**Group and Bank**						
	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
BaCB							
Financial services	**10.9**	**0.6**	**9.1**	**-**	**0.4**	**0.2**	**21.2**
Property and construction	**16.6**	**2.4**	**91.1**	**1.2**	**0.1**	**-**	**111.4**
Retail and wholesale trade	**0.3**	**69.2**	**0.1**	**0.3**	**-**	**-**	**69.9**
Services	**22.0**	**6.3**	**5.1**	**1.4**	**-**	**-**	**34.8**
Business banking	**0.3**	**27.6**	**8.3**	**4.3**	**0.6**	**0.2**	**41.3**
Other	**50.2**	**56.0**	**10.7**	**8.6**	**-**	**-**	**125.5**
Total BaCB	**100.3**	**162.1**	**124.4**	**15.8**	**1.1**	**0.4**	**404.1**

2016	Group and Bank						
	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
BaCB							
Financial services	16.4	36.9	10.8	0.5	-	-	64.6
Property and construction	29.2	3.8	126.7	4.7	-	1.3	165.7
Retail and wholesale trade	0.6	73.9	0.4	4.4	-	-	79.3
Services	43.2	16.0	5.3	2.3	-	-	66.8
Business banking	0.5	19.0	23.2	5.7	0.5	0.2	49.1
Other	62.4	69.9	33.5	11.9	1.2	1.3	180.2
Total BaCB	152.3	219.5	199.9	29.5	1.7	2.8	605.7

Legacy Portfolio

The Legacy portfolio represents 76.4% of gross Corporate customer balances and commitments, with 86.7 % of the corporate Legacy portfolio balances being rated as either strong or good. These strong and good balances are driven predominantly by Housing Association and PFI customers, which in turn represent 32.0% and 48.3% of total Legacy portfolio balances. During 2017 Legacy portfolio reduced its exposure to Property and Construction to 10.5% from 15.4% in 2016.

The reduction in Legacy portfolio exposures during 2017 reflects the continued deleveraging in line with the Bank's risk appetite. It is most evident in Property and Construction, Renewable Energy and Housing Associations sectors. Within the Property and Construction sector Commercial Property Investment has continued to see the most significant reduction in exposures in the default category.

The tables below show the distribution of the Legacy portfolio balances (including commitments) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories.

Unaudited

2017	**Group and Bank**						
	Standardised	**Strong**	**Good**	**Satisfactory**	**Weak**	**Default**	**Total**
Legacy Portfolio							
Housing associations	**-**	**419.0**	**-**	**-**	**-**	**-**	**419.0**
PFI	**-**	**607.7**	**9.8**	**-**	**15.3**	**-**	**632.8**
Property and construction	**0.2**	**2.7**	**79.8**	**4.2**	**7.7**	**43.6**	**138.2**
Renewable energy	**43.5**	**-**	**-**	**-**	**-**	**-**	**43.5**
Other	**40.2**	**14.5**	**3.1**	**1.9**	**0.1**	**18.0**	**77.8**
Total Legacy Portfolio	**83.9**	**1,043.9**	**92.7**	**6.1**	**23.1**	**61.6**	**1,311.3**
Total Corporate Portfolio	**184.2**	**1,206.0**	**217.1**	**21.9**	**24.2**	**62.0**	**1,715.4**

2016	Group and Bank						
	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
Legacy Portfolio							
Housing associations	4.2	580.9	-	-	-	-	585.1
PFI	-	287.8	379.0	0.1	-	-	666.9
Property and construction	9.8	-	142.4	18.4	11.7	83.7	266.0
Renewable energy	80.1	-	-	-	-	9.0	89.1
Other	33.3	50.8	5.1	5.9	-	24.3	119.4
Total Legacy Portfolio	127.4	919.5	526.5	24.4	11.7	117.0	1,726.5
Total Corporate portfolio	279.7	1,139.0	726.4	53.9	13.4	119.8	2,332.2

Collateral

Various forms of collateral are used, including guarantees, to mitigate credit risk. Property collateral for corporate lending is categorised as security for property development investment customers (i.e. 'property' lending) or owner occupied premises to secure mainstream loan and overdraft facilities. For general lending, in addition to taking charges over property assets owned by the customer, other security is taken in modest proportion to the total portfolio. This includes debentures or floating charges, cash cover and guarantees (often supported by tangible security where appropriate, including property, life policies and stocks and shares).

Property valuations are obtained when the facility is first approved and our lending procedures typically require collateral to be revalued every two years or more frequently in higher risk situations (typically annually or when a material change has occurred that is likely to affect the value and/or recoverability of the debt). For sectors such as Housing Associations, which have exhibited zero defaults historically, revaluations would be required every three years or more. In certain circumstances, such as syndicates, the multi bank facility letter may preclude revaluations at the customer's expense, of all the assets as frequently as this and a decision is required by all banks involved to decide if they require the updates more frequently.

The table below analyses the market value of the property collateral held against assets across all sectors:

Audited

	Group and Bank					
	2017			2016		
	Exposure	**Collateral[1]**	**Impairment provision**	Exposure	Collateral[1]	Impairment provision
BaCB						
Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term						
Less than or equal to 50%	**9.6**	**9.6**	**-**	28.9	28.9	-
Greater than 50% to less than or equal to 80%	**12.5**	**12.5**	**-**	12.7	12.6	-
Greater than 80% to less than or equal to 100%	**-**	**-**	**-**	5.3	5.2	0.1
Greater than 100%	**-**	**-**	**-**	-	-	-
Unsecured	**2.8**	**-**	**0.4**	39.5	-	0.5
	24.9	**22.1**	**0.4**	86.4	46.7	0.6
Non-default loans with >1 year until refinancing and all non-loan non-defaulted exposures regardless of term						
Less than or equal to 50%	**121.2**	**121.2**	**-**	146.3	146.3	-
Greater than 50% to less than or equal to 80%	**76.0**	**76.0**	**-**	142.2	142.2	-
Greater than 80% to less than or equal to 100%	**7.4**	**7.4**	**-**	20.0	20.0	0.1
Greater than 100%	**5.9**	**3.4**	**-**	11.1	6.1	-
Unsecured	**168.7**	**-**	**0.3**	199.7	-	0.3
	379.2	**208.0**	**0.3**	519.3	314.6	0.4
Total BaCB	**404.1**	**230.1**	**0.7**	605.7	361.3	1.0

Audited

	Group and Bank					
	2017			2016		
	Exposure	**Collateral[1]**	**Impairment provision**	Exposure	Collateral[1]	Impairment provision
Legacy Portfolio						
Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term						
Less than or equal to 50%	**3.9**	**3.8**	**-**	35.5	35.4	0.1
Greater than 50% to less than or equal to 80%	**33.7**	**31.8**	**1.8**	52.6	52.6	-
Greater than 80% to less than or equal to 100%	**1.6**	**1.2**	**0.3**	2.0	1.7	0.3
Greater than 100%	**38.8**	**19.3**	**19.0**	44.6	17.4	26.5
Unsecured	**24.1**	**-**	**8.2**	36.7	-	19.0
	102.1	**56.1**	**29.3**	171.4	107.1	45.9
Non-default loans with >1 year until refinancing and all non-loan non-defaulted exposures regardless of term						
Less than or equal to 50%	**162.9**	**162.9**	**-**	334.2	334.2	-
Greater than 50% to less than or equal to 80%	**342.6**	**342.6**	**-**	473.5	473.5	-
Greater than 80% to less than or equal to 100%	**91.8**	**91.8**	**-**	52.7	52.7	-
Greater than 100%	**64.1**	**28.5**	**-**	73.5	34.7	-
Unsecured	**547.8**	**-**	**0.9**	621.2	-	1.6
	1,209.2	**625.8**	**0.9**	1,555.1	895.1	1.6
Total Legacy Portfolio	**1,311.3**	**681.9**	**30.2**	1,726.5	1,002.2	47.5

1. Collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank. For the purposes of determining capital and impairment appropriate forced sale discounts are applied to collateral. As at 31 December 2017 £1.7m (2016: £2.9m) of the collateral is not held as first charge.

Impairment

Corporate loans have three distinct categories. These are live, watchlist and default. Impaired assets comprise watchlist and default cases.

Past due and impaired exposures are monitored via a watchlist status that contains specific triggers that, when met, result in the customer being classed as watchlist. These triggers include cash flow pressures, failure to pay interest when it falls due, potential insolvency event and unsatisfactory account operation. Watchlist accounts are considered as being at risk and require close control, but not sufficiently so to warrant the raising of specific bad and doubtful debt provision or meeting the regulatory definition of default.

After a period of satisfactory performance, customers may be removed from watchlist status. Prior to removal, satisfaction must be obtained that the relevant trigger events no longer apply. The decision to remove an account from watchlist status should be supported by appropriate MI at the point of removal depending upon the nature of the initial triggers.

Audited

	Group and Bank			
	2017		2016	
	BaCB	**Legacy Portfolio**	BaCB	Legacy Portfolio
Gross loans and advances[1]	**313.8**	**1,164.9**	499.0	1,532.6
of which impaired	**12.8**	**95.9**	29.4	136.2
Impaired as a % of gross loans and advances	**4.1%**	**8.2%**	5.9%	8.9%
Allowance for losses	**0.7**	**30.2**	1.0	47.5
Coverage – impaired assets	**5.5%**	**31.5%**	3.4%	34.9%
Coverage – total book	**0.22%**	**2.59%**	0.20%	3.10%

1. All ratios are based on gross loans and advances, which include other accounting adjustments.

The recovery of customer arrears are managed on a gross customer balance basis (excluding credit fair value adjustments and other accounting entries).

BaCB gross loans and advances have reduced in the year reflecting a mix of cases that have been repaid/rebanked and maturities/amortisations that have not been replaced with new advances. Impaired balances reduced by £16.6m (56.5%) in the year driven largely by an individual borrower transferring to Legacy portfolio.

Following the trend of prior years, Legacy portfolio gross loans and advances have decreased in the year reflecting the deleverage activity from re-banking and non performing work outs. The deleverage of both impaired and not impaired assets in 2017 results in the proportion of impaired loans remaining relatively stable in the period at 8.2% (2016: 8.9%). The provision reduced by £17.3m in the period due to write-offs (£15.1m) and a net (£2.2m) release of provisions.

The movements in impaired customer balances during the year are shown below:

Audited

	Group and Bank			
	2017		2016	
	BaCB	**Legacy Portfolio**	BaCB	Legacy Portfolio
Balance at start of year	**29.4**	**136.2**	32.8	354.1
Classified as impaired during the year	**10.6**	**34.3**	21.9	115.9
Transferred to unimpaired during year	**(4.1)**	**(19.5)**	(12.0)	(19.8)
Amounts written off	**-**	**(15.1)**	(0.5)	(91.6)
Net repayments and other	**(23.1)**	**(40.0)**	(12.8)	(222.4)
Balance at the end of the year	**12.8**	**95.9**	29.4	136.2

Forbearance

The identification of financial difficulty is a key part of the process of deploying forbearance. For those customers that benefit from ongoing concessions (such as postponement of principal payments), the forbearance status is retained for as long as the concession remains in place. In the event of one off concessions (such as capitalisation of interest payments), the forbearance status is required to be removed 12 months after the occurrence, provided that the loan has been kept up to date during that period and all covenants continue to be met.

Forbearance concessions are considered to be objective evidence of impairment and include:

- a partial write off of debt, following which the account continues to be classified as impaired for at least six months; or
- a material postponement or forgiveness of interest or waiver or reduction of normal fees and charges; the accounts must remain impaired while such favourable terms are being applied.

The table below analyses the exposures subject to forbearance:

Unaudited

	Group and Bank					
	2017			2016		
	Forborne	**Non-forborne**	**Total**	Forborne	Non-forborne	Total
BaCB						
Default	**0.2**	**0.3**	**0.5**	-	2.8	2.8
On watch list	**0.6**	**12.6**	**13.2**	11.8	17.9	29.7
Neither default nor on watch list	**-**	**390.4**	**390.4**	-	573.2	573.2
Total BaCB	**0.8**	**403.3**	**404.1**	11.8	593.9	605.7
Legacy Portfolio						
Default	**8.1**	**53.5**	**61.6**	22.3	94.7	117.0
On watch list	**15.3**	**20.0**	**35.3**	0.7	22.7	23.4
Neither default nor on watch list	**-**	**1,214.4**	**1,214.4**	-	1,586.1	1,586.1
Total Legacy Portfolio	**23.4**	**1,287.9**	**1,311.3**	23.0	1,703.5	1,726.5
Total Corporate Portfolio	**24.2**	**1,691.2**	**1,715.4**	34.8	2,297.4	2,332.2

Overall forborne exposure has reduced as overall exposure reduces. The increase in Legacy forborne balances relates to a PFI case where covenants are being renegotiated. It is expected to return to a performing loan during 2018 and any loss is not expected.

3.2.2 Investment securities

No allowance for losses has been recognised for investment securities in either 2017 or 2016. All are classified as low to medium risk. For further information see note 15 to the consolidated financial statements.

Credit risk mitigation

There are policies in place with regard to the management and valuation of collateral which are used as form of credit risk mitigation. Only cash deposits, UK government bonds or other debt securities issued by a central government or qualifying multi-lateral development bank with a minimum rating of AA are accepted as collateral. It is also a requirement of the Treasury Credit Risk Policy that all securities received as collateral are valued on a daily basis and collateral calls made in line with the relevant legal agreement.

Impaired assets

Investment securities are considered past due when the contractual interest or principal payments are in arrears and it is determined that all principal and interest outstanding will be collected according to the contractual terms of the agreements. Investment securities are considered impaired where it is determined all principal and interest outstanding will not be collected, according to the contractual terms of the agreements.

At the balance sheet date, investment securities are reassessed for objective evidence that an impairment loss has occurred. Particular consideration is given to evidence of any significant difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

Only investments in treasury assets which have a rating from an external credit rating agency equivalent to a rating by Fitch Rating Services of A or above are made.

3.2.3 Loans and advances to banks

None of the exposures in terms of loans and advances to banks are impaired. These exposures are currently considered to all be of low to medium risk.

3.2.4 Derivative financial instruments

During 2017 all new derivative transactions continued to be cleared through a central clearing counterparty and agreement has been sought from a number of counterparties to re-book existing derivative transactions through a central clearing counterparty. In accordance with IFRS 13, a credit value adjustment (CVA) of £0.7m was recorded (31 December 2016: £1.1m) in relation to non-collateralised swaps; the reduction being mainly due to the reduction in the book size.

Audited

	Group and Bank			
	2017		2016	
	Derivative notional	**Derivative fair value (net)**	Derivative notional	Derivative fair value (net)
Interest rate				
Bi-lateral collateral agreements	**12,291.1**	**(243.6)**	12,670.3	(324.8)
One way collateral[1]	**2,466.8**	**28.7**	1,295.7	30.8
No collateral agreement	**417.2**	**132.2**	517.6	152.4
Foreign exchange				
Bi-lateral collateral agreements	**25.9**	**0.2**	2.4	(0.5)
One way collateral[1]	**-**		293.2	123.3
No collateral agreement	**6.0**	**(0.1)**	81.7	(0.2)
	15,207.0	**(82.6)**	14,860.9	(19.0)

1. The above table separately identifies one way collateral agreements. Further disclosures on derivatives are contained in note 16 to the consolidated financial statements.

3.2.5 Wholesale credit risk

The Treasury portfolio is held primarily for liquidity management purposes and, in the case of derivatives, for the purpose of managing market risk. Exposures to the UK government and the Bank of England account for 73% (2016: 60%) of all Treasury exposures. The remaining exposures are split 13% (2016: 19%) to residential mortgage backed securities, 8% (2016: 13%) to financial institutions and 6% (2016: 8%) non-domestic sovereign and qualifying multi-lateral development bank bonds.

3.2.5.1 Direct exposures

Within the Treasury portfolio there are a number of risk mitigation techniques available including netting and collateralisation agreements. Other methods such as disposal and credit derivatives are used periodically to mitigate the credit risk associated with particular transactions.

Treasury operates a risk based approach which monitors counterparty limits and exposure. Both the counterparties and assets held are monitored against a Board approved matrix of risk tolerance and associated indicators. The scope of this monitoring activity includes rating actions, market events and financial results as they are announced. These factors may influence a change in risk status and possible escalation requiring management actions and inclusion on the Watchlist.

The Treasury risk team monitors the portfolio and Watchlist daily for appropriate risk status bandings and any associated management actions. As at 31 December 2017 there were no red (highest risk) exposures outstanding (2016: £nil).

During 2017, exposures to financial institutions in European countries were broadly consistent with the year end with a total gross exposure outstanding at 31 December 2017 of £188.0m (2016: £47.0m). Post credit risk mitigation the net exposure was £131.0m (2016: £47.0m).

3.2.5.2 Indirect exposures

Treasury monitoring extends beyond direct risk incurred through counterparty trading to the underlying exposures which Treasury's counterparties may maintain on their own balance sheets. In analysing each counterparty's secondary exposure, the vulnerability and impact on that counterparty is assessed should it suffer different degrees of losses.

Where secondary sovereign exposure or contagion risk is deemed to undermine the performance of the counterparty, remedial management actions are taken in respect of treasury's counterparty limits and exposure.

4. Market risk

4.1 Overview - Unaudited

Market risk is the risk of loss as a result of the value of financial assets or liabilities (including off-balance sheet instruments) being adversely affected by movements in market rates or prices. This loss can be reflected in the near term earnings by changing net interest income, or in the longer term because of changes in the economic value of future cash flows.

The main source of market risk are mismatches between the re-pricing profiles of asset and liability customer products, certain characteristics embedded within these products, sovereign swap spread risk and credit spread risk . Whilst there is no trading book, the Treasury function does create both market risk through its various portfolio management activities and employs risk management strategies to reduce earnings volatility.

Given there is no trading book and the net currency positions are below the required threshold, no Pillar 1 market risk requirement exists. All market risk exposures are addressed under the PRA Pillar 2 framework, which is captured as part of the ICG requirement.

The main measure utilised in market risk is PV01, which measures the sensitivity of the net present value to a one basis point parallel shift in interest rates. The PV01 is the daily calculation of the effect on the Net Present Value (NPV) of assets, liabilities and derivatives to both parallel and specific point of yield curve stress testing (i.e. non-linear yield curve shifts) by one basis point. Analysis includes daily parallel shifts in yield curve rates of +/- 100bps with the resultant change in NPVs representing the potential change in portfolio values.

Market risk exposures have been maintained well within overall risk appetite which has decreased since the end of 2016. Interest rate risk when expressed in terms of PV01 averaged £4.4k during the year of 2017 with a low of £(51.0)k and a high of £79.0k. A reduction in both the holding and duration of sovereign bond exposures has contributed to a reduction in swap spread risk which has fallen to a PV01 of £(779.0)k (31 December 2016: £(892.0k)). There has also been a similar reduction in other credit spread exposures which primarily reflect holdings in Warwick Finance One and Warwick Finance Two securitisations. Further deleverage of the Optimum portfolio resulted in a further securitisation (Warwick Finance Three). For Warwick Finance Three, a public deal similar in structure to that of Warwick Finance One and Warwick Finance Two was considered, but the decision was made to enter into a private bilateral transaction whereby a single investor buys 95% of the securitisation liabilities generated from the underlying Optimum portfolio, beneficially sold to a special purpose vehicle (SPV). Due to the difference in structure of the transaction we only retained approximately £90m of these securitised notes. A combination of repayments and an outright sale has seen the notional holding of residential mortgage backed securities (RMBS) fall from £1,318.0m at 31 December 2016 to £907.7m at 31 December 2017, partially offset by the Warwick Finance Three retention of £90.0m.

4.2 Primary risk metrics and sources of market risk - Unaudited

The key drivers of market risk faced and the metrics used to manage those risks are:

Interest rate risk

The primary risk metric employed to manage directional interest rate risk and yield curve risk is the sensitivity of the Bank's net present value to a one basis point parallel shift in interest rates (PV01). Limits are set at an overall level for directional interest rate risk and against individual time buckets for yield curve risk.

To supplement the gapped and overall PV01 limits noted above, stress testing of exposures against historical yield curve shifts is undertaken on a monthly basis. This assesses the sensitivity to the most extreme curve steepening and curve flattening movements, to a 99% confidence, seen over a one month period during the previous ten years.

A key aspect in the management and measurement of interest rate risk is the modelling of the behaviour of certain elements of the balance sheet. Behavioural assumptions are limited to the treatment of non-interest bearing balances and expectations with regard to customer prepayments within the residential mortgage and unsecured loan portfolios. The current account portfolio is periodically assessed in order to identify a stable, non-interest bearing 'core' element compared to the more volatile, rate sensitive and transitory balances. A behavioural duration is applied to the former while the latter are assumed to reprice within one month. Other non-maturity deposits are not subject to a behavioural adjustment and are assumed to reprice within one month.

Similar assumptions are made for other non-interest bearing balance sheet items such as non-dated capital all of which are reviewed and approved by the ALCo on a semi-annual basis.

In addition to the balance sheet items noted above interest rate risk is primarily driven by the holding of fixed rate assets within its liquidity asset buffer, the sale of fixed rate mortgages and savings products to its customer base and the degree to which these are hedged using the derivative instruments.

Risk exposures are formally calculated at least monthly. Interest rate risk and effectiveness of hedging is monitored at a minimum weekly using gap positions, incorporating new business requirements. Draw down risk, in particular for fixed rate mortgages, is managed through weekly tranche meetings. Treasury undertakes hedges for interest rate risk using derivative instruments and investment securities to external wholesale markets.

Basis risk
The definition of basis risk is the risk of loss as a result of the balance sheet being adversely affected by the movement between different index rates.

Basis risk in the balance sheet is mainly driven by a mix of exposures to LIBOR (London Interbank Offered Rate), base rate and administered rate. LIBOR exposures are created through the holding of LIBOR linked assets such as RMBS and as a result of hedging fixed rate Retail products and fixed rate sovereign debt. Reserve balances at the Bank of England and tracker mortgages generate a base rate asset with administered rate exposures generated by mortgages and savings products.

Basis risk is managed using an earnings at risk based metric, focusing in detail on the sensitivity of changes in interest rates on net interest income over a one year period. The assumed potential loss of earnings reflects the downside risk comparing the prevailing relevant spreads against their historical extremes. The estimated earnings at risk is then expressed as a percentage of the forecasted net interest income over the next twelve months.

Basis risk is monitored by Treasury Management Credit Risk Forum (TMCRF) and ALCo monthly with action taken as required.

Sovereign swap spread risk
Swap spread risk is defined as the sensitivity of the combined economic value of sovereign securities and their associated derivative hedges to changes in the spread between benchmark sovereign bond yields and swap rates. These assets are used for liquidity purposes within the Treasury portfolio.

Swap spread risk is managed by calculating on a daily basis the sensitivity of its hedged fixed rate bond portfolio to a one basis point divergence in yields between the fixed rate bond and its hedge (PV01).

Credit spread risk
Credit spread risk is defined as the risk of loss from changes in the credit spread on wholesale assets.

Non-sovereign term exposures relate primarily to holdings of residential mortgage backed securities issued by Warwick Finance One, Warwick Finance Two and Warwick Finance Three which reflect the retained elements from the deleveraging of the Bank’s assets. The potential risk from these holdings is assessed against historical spread movements of similar securitisation transactions. Given that we do not seek to actively transact in this type of asset, each purchase is individually agreed by ALCo and a maximum notional limit set.

Foreign exchange risk
The exposure to foreign exchange risk is primarily limited to customer hedging transactions and incidental customer transactions. Therefore, to manage this risk an overall maximum notional net Sterling position limit is set for both intra-day and overnight exposures. This is supported by applying sub-limits to currencies by tier to reflect their liquidity.

Where non-Sterling debt securities or short term borrowings have been originated, both currency and interest rate risk is mitigated using off setting assets or derivative instruments such as cross currency swaps.

The table below is an analysis of the assets and liabilities by currency in Sterling equivalent terms.

Audited

	Group and Bank									
	2017					Re-presented[1] 2016				
	£	**$**	**€**	**Other**	**Total**	£	$	€	Other	Total
Assets										
Cash and balances at central bank	**4,032.1**	**-**	**-**	**-**	**4,032.1**	2,848.2	-	-	-	2,848.2
Loans and advances to banks	**549.5**	**11.4**	**13.3**	**0.6**	**574.8**	620.7	20.5	15.9	1.2	658.3
Loans and advances to customers	**16,741.5**	**3.0**		**-**	**16,744.5**	19,404.8	30.5	17.3	0.1	19,452.7
Fair value adjustments for hedged risk	**70.3**	**-**	**-**	**-**	**70.3**	131.6	-	-	-	131.6
Loans and receivables	**100.0**	**-**	**-**	**-**	**100.0**	11.0	1.8	1.0	-	13.8
Available for sale	**2,287.7**	**-**	**-**	**-**	**2,287.7**	3,538.1	-	-		3,538.1
Derivative financial instruments	**232.4**	**-**	**-**	**-**	**232.4**	425.6	-	(0.1)	-	425.5
Other assets	**420.0**	**24.0**	**4.3**	**-**	**448.3**	341.5	-	-	-	341.5
Total assets	**24,433.5**	**38.4**	**17.6**	**0.6**	**24,490.1**	27,321.5	52.8	34.1	1.3	27,409.7
Liabilities										
Deposits by banks	**1,122.7**	**-**	**-**	**-**	**1,122.7**	1,020.0	-	-	-	1,020.0
Customer accounts[2]	**20,624.7**	**3.9**	**6.0**	**0.4**	**20,635.0**	22,374.4	20.4	30.3	-	22,425.1
Customer accounts - capital bonds	**-**	**-**	**-**	**-**	**-**	11.8	-	-	-	11.8
Debt securities in issue	**627.4**	**-**	**-**	**-**	**627.4**	1,209.1	232.1	184.2	-	1,625.4
Derivative financial instruments	**315.0**	**-**	**-**	**-**	**315.0**	444.5	-	-	-	444.5
Other borrowed funds	**-**	**-**	**-**	**-**	**-**	472.6	-	-	-	472.6
Other liabilities	**284.3**	**-**	**0.1**	**-**	**284.4**	448.1	2.3	1.3	0.1	451.8
Total liabilities	**22,974.1**	**3.9**	**6.1**	**0.4**	**22,984.5**	25,980.5	254.8	215.8	0.1	26,451.2
Net assets	**1,459.4**	**34.5**	**11.5**	**0.2**	**1,505.6**	1,341.0	(202.0)	(181.7)	1.2	958.5

1. The comparative figures have been re-presented to more fairly reflect their nature. Further information can be found in notes 13 and 22 to the consolidated financial statements.
2. The total balance for customer accounts for the Bank is £20,635.1m and the Sterling balance is £20,624.8m. All other balances and currencies are consistent with Group.

At 31 December 2017, the Bank's open currency position was £(0.4)m (2016: £1.4m). Currency positions are managed against both an overall limit and individual currency limits.

Other sources of market risk – unaudited

Other sources of market risk include:

- Prepayment risk – the risk that an asset or liability repays more quickly or slowly than anticipated, resulting in a mismatch between the asset, liability and associated hedge;
- Pipeline risk – the risk that the sales profile for new fixed rate products do not match hedging assumptions, resulting in a mismatch between amount of product sold and that hedged, which can result in a hedge rebalancing cost;
- Equity price risk – the risk that the fair value of equities decreases as a result of changes in the level of equity indices and individual stocks. Non-trading equity price risk exposure arises from equity securities classified as available-for-sale. A 10% increase in the value of available for sale equities at 31 December 2017 would equate to an increase of £2.7m (2016: £4.7m). An equivalent decrease would reduce the value by the same degree;
- Explicit option risk – the sensitivity to overall direction of interest rates, speed of change of interest rates and market prices for positions which contain explicit options e.g. caps, floors, swaptions;
- Repricing and implicit optionality in products – the risk that options embedded or implied within Retail or commercial products have an impact on market value or earnings with changing interest rates; and
- Illiquidity risk – the Bank's risk appetite for market risk considers an illiquidity risk which is reflected in the assumed holding period it uses to assess its capital requirements for market risk.

Unaudited

	Group and Bank	
	2017	2016
Total PV01 (£k)	**12.0**	(5.0)
Average PV01 for the year (£k)	**4.4**	61.9
Largest positive PV01 for the period (£k)	**79.0**	178.0
Largest negative PV01 for the period (£k)	**(51.0)**	(5.0)
Average basis risk (% of annual NII)	**0.7%**	0.5%
Swap spread PV01 (£k)	**(779.0)**	(892.0)
Average swap spread PV01 (£k)	**(799.9)**	(921.5)
RMBS holding (£m)	**907.7**	1,318.0
Average RMBS Holding (£m)	**1,004.2**	1,457.3
FX notional (£m)	**(0.4)**	1.4
Average FX notional (£m)	**(0.4)**	0.3

The table illustrates the PV01, Basis risk, Swap spread and FX risk metrics on the balance as at the period end. The PV01 is primarily driven by the non-sensitive balances offset by corresponding asset or derivative positions. During 2017 the largest absolute PV01 exposure of £79k reflected the short term impact following the completion of the Restructuring and Recapitalisation exercise, where the Group's capital position increased by c£700m. This exposure was subsequently reducing as appropriate hedging activity was undertaken.

The basis risk exposure in terms of potential earnings at risk and notional has remained relatively stable through 2017 and primarily reflects a net LIBOR asset funded by administered rate liability. Swap spread risk has continued to reduce through 2017 due to a reduction in both notional value and duration of the fixed rate sovereign bonds held within its liquid asset portfolio. RMBS holdings have reduced by approximately £410.0m reflecting an outright sale of a portion of the Warwick Finance holdings and the impact of the quarterly pay down of these notes partially offset against the retention of £90.0m Warwick Finance Three notes.

5. Liquidity and funding risk

5.1 Overview

The Board determines the level of liquid resources required to support the business objectives through the risk appetite and by undertaking an Internal Liquidity Adequacy Assessment Process (ILAAP). The ILAAP process involves the review of the liquidity Risk Management Framework, the assessment of the exposure to qualitative and quantitative liquidity and funding risks (including under stressed conditions it evaluates the liquidity and funding requirements of the Bank's financial projections) and concludes on the adequacy of its liquid resources.

The ILAAP and compliance with the Overall Liquidity Adequacy Rule (OLAR) is reviewed and approved by the Board and is reviewed by the PRA as part of the Liquidity Supervisory Review and Evaluation Process (L-SREP). Following the L-SREP, the PRA issues Individual Liquidity Guidance (ILG) which determines the amount of liquidity which is required to be held in Pillar 2. On 1 October 2015 the LCR became the primary regulatory standard for liquidity and ILG is set with reference to liquidity coverage ratio (LCR). LCR is being introduced on a phased basis and UK banks are now required to maintain a minimum of 90% of LCR and rising to 100% in 2018.

To manage liquidity and funding risk the following are monitored:

- funding and cashflow profile;
- maturity concentrations;
- total liquid asset portfolio;
- asset encumbrance;
- stress testing; and
- assessing market conditions for stress and contingency planning.

The Group has an established funding base, predominantly comprising Retail and commercial deposits. The liquidity position is monitored and managed, maintaining a regulatory liquidity buffer appropriate for our funding profile in order to ensure financial obligations are met as and when they fall due. In a more severe stress, in the first instance the Contingency Funding Plan (CFP) would be invoked. Then the Recovery Plan could be invoked, maintained under UK regulatory rules implementing the European Bank Recovery and Resolution Directive (BRRD), which documents a number of potential management actions.

5.2 Liquidity Risk Management Framework and risk policies - Unaudited

Liquidity management information is provided on a regular basis to ALCo and the Board which details compliance with key liquidity risk metrics, which include:

- liquidity coverage ratio (LCR), 213.0% (2016: 213.5%) which represents a surplus to regulatory requirements. The strong liquidity position aligns to the risk strategy to maintain a prudent liquidity position, although the surplus to regulatory requirements may vary due to cash flow mismatches and fluctuations in the funding profile over time;
- internal liquidity stress tests – the survival period under an applicable stress scenario. A buffer was held in excess of the requirements from the applicable stress scenario at 31 December 2017;
- customer loan/deposit ratio, 81.1% (2016: 86.7%) – the ratio of customer loans (excluding credit commitments) to customer deposits; and
- encumbrance ratio, 15.1% (2016: 17.8%) – per the EBA definition, asset encumbrance ratio = (carrying amount of encumbered assets and collateral)/(total assets and collateral).

An asset is defined as encumbered if it has been pledged as collateral against an existing liability or to collateralise an exposure that the Group may have, restricting access to that asset in the event of resolution or bankruptcy. An encumbered asset would be no longer available to use in secured funding, to satisfy collateral needs or to be sold to reduce the funding requirement.

The encumbrance table is presented in Pillar 3 (5.3 Liquidity and funding –Table 35).

5.3 Liquid asset portfolios – Unaudited

Total liquidity resources as at 31 December 2017 were £9,965.2m (2016: £8,240.3m). There is a focus on maintaining a high percentage of liquid assets which are high-quality and the table below analyses the liquidity portfolio by product and unencumbered liquidity value. The liquidity portfolio is categorised into primary and secondary (other liquid assets and contingent liquidity).

Primary liquid assets include cash and balances at central banks, gilts and other high quality government bonds. The increase in primary liquidity relates mainly to the Warwick Finance Three transaction in October and the £250m cash inflow relating to the Restructuring and Recapitalisation partially offset by Euro medium term note (EMTN) maturity in September.

Secondary liquidity comprises unencumbered liquid investment securities not included as part of primary liquidity as well as other forms of contingent liquidity sources. The increase in secondary liquidity is a combination of the increase in the collateral eligible for central bank facilities partially offset by mortgage redemptions, amortisation and sale of retained securities and management of secured funding collateral requirements.

	Group and Bank	
	2017	2016
Operational balances with central banks	**3,815.5**	2,571.4
Gilts	**423.1**	676.2
Central government and multilateral development bank bonds	**348.7**	568.5
Total primary liquid assets	**4,587.3**	3,816.1
Other liquid assets	**1,186.1**	727.2
Contingent liquidity	**4,191.8**	3,697.0
Total liquidity	**9,965.2**	8,240.3
Average balance	**9,151.5**	9,061.2

A combination of these asset pools is used to manage liquidity, with primary liquidity used predominantly for short term cash flow movements, while other liquidity is used for creating longer term liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid.

Included within the primary liquid asset balance above is £298.7m (2016: £178.0m) of UK government gilts obtained through a collateral upgrade transaction. In accordance within the recognition criteria for financial assets under International Accounting Standards (IAS 39 Financial Instruments: Recognition and measurement), these gilts are not recognised on the Bank's balance sheet. The above reporting is based on what is eligible for liquidity purposes and so does not exactly match the balance sheet.

5.3.1 Wholesale funding – Unaudited

Wholesale funding is used to supplement Retail and commercial deposits to diversify the source of funds to support the business plan. There are a variety of long term wholesale funding sources outstanding, including securitisations, covered bond and medium term notes, as shown in the table below:

	Group and Bank	
	2017	Re-presented 2016
Subordinated debt[1]	**-**	472.6
Secured funding	**601.9**	1,197.6
Repos	**1,120.3**	990.6
Market borrowing	**1.3**	4.1
MTNs	**-**	405.4
Total wholesale funding	**1,723.5**	3,070.3

1. Re-presented to include accrued interest and fair value adjustment.

The reduction in wholesale funding primarily reflects the repayment of secured funding in the period. Gilt repos make up £820.1m of total repo funding. Subordinated Debt is £nil in 2017 as a result of the Restructuring and Recapitalisation activity.

The following table sets out contractual wholesale funding by maturity, with the maturity of securitisations based on call dates:

	Group and Bank	
	2017	Re-presented 2016
Repayable in less than 1 month	**1,021.5**	837.4
Repayable between 1 and 3 months	**-**	-
Repayable between 3 and 6 months	**100.1**	528.9
Repayable between 6 and 9 months	**-**	405.4
Repayable between 9 and 12 months	**-**	67.9
Repayable between 1 and 2 years	**-**	-
Repayable between 2 and 5 years[1]	**601.9**	1,024.6
Repayable in more than 5 years[1]	**-**	206.1
Total external funding	**1,723.5**	3,070.3

1. Re-presented to include accrued interest and fair value adjustment.

The above funding can be found within Deposits by banks, Debt securities in issue and for 2016, Other borrowed funds on the balance sheet with a number of items excluded.

5.4 Liquidity Gap – Audited

Details of contractual maturities for assets and liabilities underpin the management of liquidity risk, however, management recognises that customer behaviour differs to contractual maturity, therefore as part of the planning process, behavioural run-off of customer assets and liabilities over time are estimated. The assumptions used to create these estimates and the estimates themselves are recommended for approval by ALCo as part of its responsibility to manage the Financial Plan.

Gross cash flows include interest and other revenue cash flows. Other assets and liabilities include non-financial items and these are excluded from the maturity analysis. The following table is an analysis of gross undiscounted contractual cash flows of financial assets and liabilities held at the balance sheet date:

2017	Group and Bank									
Contractual cash flows	**Carrying value**	**Gross nominal flow**	**Less than 1 month**	**1-3 months**	**3-6 months**	**6-9 months**	**9-12 months**	**1-2 years**	**2-5 years**	**Over 5 years**
Assets										
Cash and balances at central banks	4,032.1	4,032.1	4,032.1	-	-	-	-	-	-	-
Loans and advances to banks	574.8	576.7	476.7	98.5	0.3	0.1	0.2	0.6	0.3	-
Loans and advances to customers (incl. FVAHR)	16,814.8	24,669.9	543.5	224.6	334.4	325.0	348.9	1,267.9	3,817.4	17,808.2
Investment securities										
Loans and receivables	100.0	142.6	0.1	0.2	0.3	0.3	0.3	1.4	4.1	135.9
Available for sale	2,287.7	2,387.5	3.5	6.7	10.2	10.3	12.1	179.2	1,552.0	613.5
Fair value through profit or loss	-	-	-	-	-	-	-	-	-	-
Derivative financial instruments	232.4	393.8	13.5	12.0	12.6	12.3	12.3	47.0	84.5	199.6
Other assets	448.3	-	-	-	-	-	-	-	-	-
Total recognised assets	**24,490.1**	**32,202.6**	**5,069.4**	**342.0**	**357.8**	**348.0**	**373.8**	**1,496.1**	**5,458.3**	**18,757.2**
Liabilities										
Deposits by banks	1,122.7	1,128.9	1,023.2	1.1	101.2	0.4	0.4	1.8	0.8	-
Customer accounts[1]	20,635.0	20,703.8	15,520.5	270.1	1,007.7	1,440.2	716.9	1,479.6	268.8	-
Customer accounts – capital bonds	-	-	-	-	-	-	-	-	-	-
Debt securities in issue	627.4	714.1	2.4	4.6	7.0	7.1	11.2	28.5	653.3	-
Derivative financial instruments	315.0	548.0	9.2	23.3	17.4	21.9	16.8	60.0	124.6	274.8
Other borrowed funds	-	-	-	-	-	-	-	-	-	-
Other liabilities	284.4	-	-	-	-	-	-	-	-	-
Total recognised liabilities	**22,984.5**	**23,094.8**	**16,555.3**	**299.1**	**1,133.3**	**1,469.6**	**745.3**	**1,569.9**	**1,047.5**	**274.8**
Unrecognised loan commitments	2,411.0	2,411.0	2,110.9	300.1	-	-	-	-	-	-
Total liabilities	**25,395.5**	**25,505.8**	**18,666.2**	**599.2**	**1,133.3**	**1,469.6**	**745.3**	**1,569.9**	**1,047.5**	**274.8**

1. The carrying value of customer accounts for the Bank is £20,635.1m and the gross nominal flow is £20,703.9m. The additional £0.1m is within the less than 1 month band. All other balances and timing bands are consistent with Group.

Re-presented[1] 2016	Group and Bank									
Contractual cash flows	Carrying value	Gross nominal flow	Less than 1 month	1-3 months	3-6 months	6-9 months	9-12 months	1-2 years	2-5 years	Over 5 years
Assets										
Cash and balances at central banks	2,848.2	2,848.2	2,848.2	-	-	-	-	-	-	-
Loans and advances to banks	658.3	658.5	461.8	196.7	-	-	-	-	-	-
Loans and advances to customers (incl. FVAHR)	19,584.3	27,809.0	690.4	237.4	381.6	390.9	387.9	1,497.5	4,116.9	20,106.4
Investment securities										
Loans and receivables	13.8	16.1	-	-	-	-	-	0.1	0.3	15.7
Available for sale	3,538.1	3,691.1	7.1	65.1	17.9	42.7	18.7	406.3	2,067.1	1,066.2
Fair value through profit or loss	-	-	-	-	-	-	-	-	-	-
Derivative financial instruments	425.5	641.3	6.6	12.3	142.0	19.1	16.6	61.0	154.5	229.2
Other assets	341.5	-	-	-	-	-	-	-	-	-
Total recognised assets	27,409.7	35,664.2	4,014.1	511.5	541.5	452.7	423.2	1,964.9	6,338.8	21,417.5
Liabilities										
Deposits by banks	1,020.0	997.0	837.8	0.8	90.1	0.2	68.1	-	-	-
Customer accounts	22,425.1	22,524.5	16,430.7	302.2	1,119.4	1,318.0	1,053.2	1,482.5	818.5	-
Customer accounts – capital bonds	11.8	9.3	-	2.4	3.2	2.7	1.0	-	-	-
Debt securities in issue	1,625.4	1,847.7	45.7	16.9	479.0	415.6	14.8	43.6	832.1	-
Derivative financial instruments	444.5	716.8	10.4	19.6	29.7	26.4	26.4	87.4	181.1	335.8
Other borrowed funds	472.6	699.7	3.6	7.8	10.9	21.8	10.9	44.0	350.0	250.7
Other liabilities	451.8	-	-	-	-	-	-	-	-	-
Total recognised liabilities	26,451.2	26,795.0	17,328.2	349.7	1,732.3	1,784.7	1,174.4	1,657.5	2,181.7	586.5
Unrecognised loan commitments	2,441.7	2,441.7	2,106.9	334.8	-	-	-	-	-	-
Total liabilities	28,892.9	29,236.7	19,435.1	684.5	1,732.3	1,784.7	1,174.4	1,657.5	2,181.7	586.5

1. The figures in the above table have been re-presented to more fairly reflect their nature. Further information can be found in notes 13 and 22 to the consolidated financial statements.

The principal difference between the gross nominal value and the accounting carrying value set out above is due to discounting. Discounting has a greater impact on cash flows in later years, and a minimal impact on cash flows within 1 year. Therefore the contractual cash flows on assets and liabilities expected in less than one year are a fair representation of the contractual maturity of current assets and liabilities at carrying value in the balance sheet.

Financial Statements

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE CO-OPERATIVE BANK PLC

Opinion

In our opinion:

- The Co-operative Bank plc's group financial statements (the 'Bank') and parent company (the 'Bank Company') financial statements (together the 'financial statements') give a true and fair view of the state of the Bank's and of the Bank Company's affairs as at 31 December 2017 and of the Bank's loss for the year then ended;
- the Bank financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Bank Company financial statements been properly prepared in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006, and, as regards the Bank financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of The Co-operative Bank plc (the 'Bank Company') and its subsidiaries (together, the 'Bank') which comprise:

Bank	Bank Company
Consolidated balance sheet as at 31 December 2017	Balance sheet as at 31 December 2017
Consolidated income statement for the year then ended	Statement of changes in equity for the year then ended
Consolidated statement of comprehensive income for the year then ended	Cash flow statement for the year then ended
Consolidated statement of changes in equity for the year then ended	Related notes 1 to 26 to the financial statements including a summary of significant accounting policies
Consolidated statement of cash flows for the year then ended	
Related notes 1 to 36 to the financial statements, including a summary of significant accounting policies	

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and; as regards to the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Bank and the Bank Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to going concern

We have identified going concern as a key audit matter given the significance of the assessed risk on our audit of the financial statements. As a result of our audit procedures in response to this risk we have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's or the parent company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Overview of our audit approach

Key audit matters	• Going Concern • Valuation of credit impairment provisions • Valuation of conduct and compliance risk provisions • Recognition of income using the Effective Interest Rate ('EIR') method • The Bank's control environment
Audit scope	• We performed an audit of the complete financial information of the Bank with the exception of one component where we performed specific audit procedures. • We performed specific scope audit procedures on one component which accounted for 1.1% of the Result before tax and 0.1% of Total assets.
Materiality	• Overall group materiality of £10m which represents 0.65% of equity.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Going Concern Please refer to the Audit Committee Report (page 40) and note 1.2 of the Consolidated Financial Statements (page 123). As described in the basis of preparation note, the Bank achieved a number of key milestones in 2017 which are relevant to the Directors' going concern assessment, including the successful delivery of the Restructuring and Recapitalisation which has contributed to the Bank meeting its Individual Capital Guidance (ICG) and combined buffer requirements in late 2017. As a result, the risks associated with going concern have decreased in the year. However, important considerations affecting the going concern assumption remain relevant for the period of the next 12 months.	**Our response:** Our audit procedures included evaluating the Directors' going concern assessment in order to assess whether there are events and conditions that exist that may cast significant doubt of the Bank's ability to continue as a going concern. Our procedures included: • Reviewing regulator correspondence to evidence changes in the Bank's capital requirements; • Meeting with the FCA and the PRA through the audit cycle to understand their views on existing and emerging risks to the Bank and to validate the Bank's progress on achieving regulatory milestones; • Reviewing the 2018-2022 Financial Plan including a consideration of the reasonableness of forecast income growth and cost reduction activities in the context of the going concern period; • Evaluating the progress made by the Bank in relation to Internal Ratings Based (IRB) model remediation in accordance with CRR; and • Evaluating the Directors' plans with regard to Pace pension scheme sectionalisation. We also assessed whether the Bank's disclosures in relation to going concern adequately reflected the risks and uncertainties inherent to the going concern assessment.	We concluded to the Audit Committee that we consider that the use of the going concern assumption remains appropriate. We also concluded that the remaining risks do not constitute a material uncertainty. We highlighted the following matters: The Plan contains future actions that could materially deviate from planned costs and timescales but that the strengthened capital position has enhanced the Bank's ability to absorb such unexpected events. Whilst the Bank had made progress in the remediation of its IRB models, this programme carries execution risk and could result in regulatory action such as the permission to use an IRB approach being removed or a re-imposition of a capital add-on. We concurred with the Directors' assessment that this outcome was unlikely given the progress made towards achieving compliance. The Bank's disclosures appropriately reflect the risks relevant to the going concern.
Valuation of credit impairment provisions Please refer to the Audit Committee Report (page 40); Accounting policies (page 124); and note 14 of the Consolidated Financial Statements (page 142-143). The provision for impairment of loans and advances to customers is a significant balance and carries a high degree of estimation uncertainty derived from the subjectivity of assumptions used to build the provisions. The continued deleveraging and reduction in risk within the Bank's loan portfolio has also been taken into account in determining the level of audit risk. Considering the magnitude of the provision balance, the level of estimation uncertainty and uncertainty in the UK economy as a result of Brexit, the provision for impairment continues to represent a key audit matter. The inherent ability of Management to override internal controls in relation to credit impairment provisions also represents a significant risk of fraud.	**Our response:** We understood and tested key controls in relation to Management's review of specific provisioning on corporate loans. For a sample of specific provisions we obtained an understanding of the latest developments in the borrower's situation and the factors impacting the measurement of impairment provisions. In each case we tested key data inputs and, where relevant, considered alternative scenarios in challenging Management's estimate. The Bank derives its individual impairment provisions with reference to the collateral held against each impaired loan. Our approach included the use of our own valuation specialists to assess the market value of a sample of collateral valuations. We understood and tested key controls in relation to the governance over the collective impairment process and Management's review and approval of collective impairment model outputs and post model adjustments. Our substantive audit procedures over the collective provision models included assessing, challenging and substantiating the key assumptions, such as: probability of default; forced sales discount; collateral valuation; loss given	We concluded to the Audit Committee that the provision levels held by the Bank in relation to loan loss impairment were reasonably estimated. We highlighted the following matters: The level of estimation uncertainty in the corporate loan portfolio has reduced due to active management, resolution of default cases, and portfolio sales. Based on the assessment of a sample of specific provisions, including the independent valuation of collateral, we concluded that Management's estimates were reasonable and the collateral held was appropriately valued. Through the application of independent impairment models, and an assessment of key model assumptions, we concluded that Management's modelled provisions were reasonably estimated. Provision overlays are an area of uncertainty due to the judgement involved in estimating the impact of shortfalls in modelling impairment risk.

	default and exposure at default. In order to test the reasonableness of the Bank's modelled provisions we built independent models through which we applied Management's, and alternative, assumptions to the Bank's loan portfolios. The Bank applies a number of overlays to the collective provision models in order to adjust for shortfalls in capturing impairment risk. We assessed the identified overlays for completeness using our knowledge and experience across the banking sector and tested each significant overlay for reasonableness of estimation.	
Conduct and compliance risk provisions Please refer to the Audit Committee Report (page 40); Accounting policies (page 124); and note 27 of the Consolidated Financial Statements (pages 149 - 151). The Bank carries a number of provisions for various matters including those related to the conduct of the Bank towards its past and present customers, including: Payment protection insurance mis-selling (PPI); Packaged bank accounts mis-selling (PBA); Mortgage rectification (MRI); and Non-compliance with elements of the consumer credit act (CCA). The assessment of present obligations for customer redress requires significant judgement due to uncertainties over whether an obligation exists and the subjective assumptions used to quantify potential redress levels. Whilst the risk has reduced during the year, the magnitude of the provisions and level of judgement involved means that this remains a key audit matter. The ability of Management to override internal controls in relation to conduct and compliance risk provisions also represents a significant risk of fraud.	**Our response:** After assessing the design effectiveness of key controls, we adopted a substantive approach. We tested the completeness and accuracy of data used by the Bank in creating the provisioning models. We modelled the impact of reasonably possible alternative assumptions on each of the Bank's conduct provision balances and developed an independent range of outcomes to evaluate and challenge Management's provision estimate. Completeness of the identification of issues (with the potential to lead to provisions) was assessed through discussions with Management, including General Counsel, review of regulatory correspondence and consideration of broader industry issues and developments.	We concluded to the Audit Committee that the provision levels held by the Bank in relation to conduct risk and compliance risk are reasonably estimated and recognised in accordance with IFRS. We also concluded that the Bank's disclosures, including the sensitivities disclosed in note 2.2, were appropriate and in compliance with the relevant accounting standards. We highlighted the following matters: The PPI provision remains sensitive to key assumptions, the most significant of which is future complaint volumes. Other conduct and compliance provisions are uncertain due to the judgement involved in identifying affected customer populations and future complaint volumes.
Recognition of income using the Effective Interest Rate ('EIR') method Please refer to the Audit Committee Report (page 40); Accounting policies (page 124); and note 34 of the Consolidated Financial Statements (pages 164-173). The EIR method of revenue recognition involves significant management judgement and complex calculations in both determining the initial EIR and recording the present value of adjustments arising in subsequent periods when cash flows are reforecast. As such, it represents a risk of fraud in revenue recognition and through management override of internal controls. The Bank's EIR models are most sensitive to changes in the behavioural life assumptions and future interest rate expectations. Modelled forecast cash flows may be measured incorrectly due to the use of inaccurate or incomplete data, erroneous formulae or inappropriate assumptions being used.	**Our response:** After assessing the design and implementation of controls for setting and updating EIR assumptions and methodologies, we adopted a substantive audit approach. We validated and challenged assumptions used by Management in the EIR models including the behavioural lives of assets and the forecasting of standard variable rates. We compared customer redemption assumptions with the recent customer behaviours observable in the Bank's portfolios, and assessed the consistency of forecast standard variable rates with market derived base rate forecasts and the Bank's expectations of future interest margins. We reviewed the appropriateness of key model assumptions in light of our knowledge of the Bank's portfolios and market conditions. We tested the completeness and accuracy of data within these models through agreeing the model data to the Bank's source systems. We tested the accuracy of EIR calculations by testing a sample of mortgages to the EIR balance	We concluded to the Audit Committee that the approach taken results in a reasonable estimate in the context of current observable market behaviours and economic conditions. We also highlighted that there is subjectivity in Management's assumptions concerning behavioural lives and future rates of interest. We were satisfied that the assumptions made by Management are reasonable in the context of the Bank's mortgage portfolios and current market conditions.

Due to the degree of judgement that needs to be exercised by Management around forecast future cash flows; the number of different products the Bank has across its loan portfolio and the complexity of calculation, this is considered to be a key audit matter.	as per the models.	
The Bank's control environment During 2017 the Bank has made various improvements to its control environment, particularly in relation to data governance, ledger control and financial reporting. However, we continued to identify weaknesses in the Bank's control environment in excess of what would be considered normal in the industry. As described in the Annual Report and Accounts (ARA), steps to enhance the Risk Management Framework (RMF) were concluded during 2017, although we note that further work is needed to embed this consistently across the Group. As the robustness of financial reporting depends on the effective functioning of the underlying operational and financial IT systems, as well as on the effectiveness of the Bank's wider control environment, we deemed this matter to be a key audit matter.	**Our response:** Our audit approach included an assessment of the quality and effectiveness of the key internal controls that Management relies on for financial reporting. We planned our audit to place reliance, where both possible and appropriate, on those internal controls including IT general controls where these were determined to be operating effectively. We used IT specialists within our audit team to conduct our IT procedures which included, amongst others, testing IT general controls relating to system access and change management, and testing controls over specific IT applications which are required to operate effectively to mitigate the risk of misstatement within the financial statements. Where we were unable to place such reliance we addressed the increased risk by designing and then undertaking audit procedures to obtain a greater proportion of evidence from substantive testing and the use of increased sample sizes.	We highlighted to the Audit Committee that improvements had been made to the overall control environment during 2017 but we continued to identify control weaknesses above industry norms. This led to us extending the scope of our work by identifying and testing compensating controls and undertaking further additional substantive testing. We satisfactorily obtained the necessary audit evidence from our additional substantive work.

In the prior year, our auditor's report included a key audit matter in relation to the Bank's financial statement close process. In the current year, we have considered that this has a lower likelihood of material misstatement and as a result had a lesser effect on our audit strategy, on the allocation of resources on the audit, and on directing the efforts of the engagement team. Our assessment is based on our observations and understanding of the improved control framework in this area of the Bank, improvements made to the substantiation of balances and a simplification of the Bank's ledger systems.

In addressing the five key audit matters for 2017, we undertook the procedures discussed above, which were designed in the context of the materiality of the financial statements as a whole. Consequently, we do not express any opinion on any individual area taken in isolation.

In addition, we considered whether or not the following risk fraud risk factors were present in each of these risks and to what degree, being:

- Management override of internal controls;
- Manipulation of revenue recognition; and,
- Fraudulent financial reporting.

Our work in each area was specifically designed to address these risks.

An overview of the scope of our audit

Tailoring the scope

The Bank is principally managed from one location in Manchester, with certain functions such as Treasury and some corporate activities operated from London. These functions and operations were subject to full scope audit procedures by the Bank audit team, and comprise 100% (2016: 99.9%) of the Bank's operating income, 101% (2016: 100%) of the Bank's loss before taxation and 99.9% (2016: 99.9%) of the Bank's total assets.

One legal entity was a separate component: Britannia International Limited ('BINT'), which is based in the Isle of Man and has prepared financial information on a break up basis as at 31 December 2017. This entity is not audited by Ernst & Young LLP and was subjected to a specific scope audit in relation to our audit of the Bank's financial statements.

Involvement with component teams

Detailed audit instructions were sent to the auditor of the component. These instructions specified the significant audit areas that should be covered by the audit (which included the relevant key audit matters detailed above) and set out the information required to be reported back to us. We then discussed the findings and conclusions with the non-EY component auditor as necessary.

Our application of materiality
We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality
The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Bank and Bank Company to be £10 million (2016: £10 million), which equates to 0.65% (2016: 1%) of the Bank's equity. The reason for selecting equity as the basis for our audit materiality consideration is that the Bank's stated focus is to maintain regulatory capital, as it has been loss making for several years. We also see equity, as a proxy for regulatory capital, as the main focus for the users of the financial statements given the importance of regulatory capital to the Bank's solvency.

Performance materiality
The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Bank's overall control environment, our judgement was that performance materiality should be set at 50% (2016: 50%) of our planning materiality, namely £5m (2016: £5m). 50% is at the conservative end of the normal range we use, which is 50% to 75%. We have set performance materiality at this percentage due to the issues highlighted above as regards the Bank's overall control environment and also with regard to the level of audit differences that we have historically encountered.

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Bank as a whole and our assessment of the risk of misstatement at that component. In the current year, the performance materiality allocated to the component was £0.5m (2016: £0.5m).

Reporting threshold
An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.5m (2016: £0.5m), which is set at 5% of overall materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information
The other information comprises the information included in the Annual Report and Accounts set on pages 208 to 210, other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006
In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Other information for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Other information has been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception
In the light of the knowledge and understanding of the Bank and the Bank Company and its environment obtained in the course of the audit, we have not identified material misstatements in the Other information.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Responsibilities of Directors
As explained more fully in the Directors' responsibilities statement set out on page 57 the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Bank and Bank Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Bank or the Bank Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud
The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Bank and have a direct impact on the preparation of the financial statements. We determined that the most significant are:
  - Companies Act 2006
  - Financial Reporting Council (FRC) rules and guidance
  - Tax Legislation (governed by HM Revenue and Customs)
  - Financial Conduct Authority (FCA) rules
  - CRD IV and Prudential Regulation Authority (PRA) rules
- We understood how the Bank is complying with those frameworks by reviewing relevant committee minutes and reports, holding discussions with the Bank's general counsel and internal audit, amongst others. We inquired as to any known instances of non-compliance or suspected non-compliance with laws and regulations. We also reviewed the Bank's Complaints Management Policy and Whistleblowing Policy.
- We assessed the susceptibility of the Bank's financial statements to material misstatement, including how fraud might occur, by holding discussions with senior management, internal audit and the Audit Committee.
- In conducting our audit procedures, we were aware of the risk of fraud, especially in the areas of estimation and those we assessed as having the risk of management override.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiring of key management, reviewing the key policies and reports on the aforementioned regulatory frameworks as well as reviewing the correspondence exchanged with the Regulators.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters we are required to address

- We were appointed by the company on 30 May 2014 to audit the financial statements for the year ending 31 December 2014 and subsequent financial periods. We were appointed as auditors by the Audit Committee and signed an engagement letter on 17 July 2014. The period of total uninterrupted engagement is four years, covering the years ending 31 December 2014 to 31 December 2017.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the parent company and we remain independent of the Group and the parent company in conducting the audit.
- The audit opinion is consistent with our report to the Audit Committee.

Peter Wallace (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
13 March 2018

Notes:

1. The maintenance and integrity of the Bank's web site is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE CO-OPERATIVE BANK HOLDINGS LIMITED

Opinion

We have audited the financial statements of The Co-operative Bank Holdings Limited ('the Holding Company') and its subsidiaries (the 'Group') for the year ended 31 December 2017 which comprise the Group income statement, the Group and Holding Company balance sheet, Group statement of cash flows, the Group statement of comprehensive income, the Group and Holding Company statement of changes in equity and the related notes 1 to 36 for the Group and 1 to 5 for the Holding Company, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

In our opinion:

- the financial statements give a true and fair view of the Group's and of the Holding Company's affairs as at 31 December 2017 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Holding Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the group and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's or the Holding Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The other information comprises the Chairman's Statement, Strategic Report, Chief Executive's Review, Risk Management Report, Directors' Report, Directors' Report on Remuneration and the Corporate Governance Report. The Directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Other information for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Other information has been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception
In the light of the knowledge and understanding of the Group and the Holding Company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic report or Directors' report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Holding Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Holding Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Responsibilities of Directors
As explained more fully in the Directors' responsibilities statement set out on page 57, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Holding Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Holding Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Peter Wallace (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
13 March 2018

Notes:
1. The maintenance and integrity of the web site within which these accounts are available is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

THE CO-OPERATIVE BANK HOLDINGS LIMITED FINANCIAL STATEMENTS (GROUP)
THE CO-OPERATIVE BANK PLC FINANCIAL STATEMENTS (BANK)
Consolidated income statement
For the year ended 31 December 2017
All amounts are stated in £m unless otherwise indicated

		Group		Bank	
	Note	**2017**	2016	**2017**	2016
Interest receivable and similar income	6	**554.9**	737.8	**554.9**	737.8
Interest expense and similar charges	6	**(291.2)**	(517.5)	**(291.2)**	(517.5)
Net interest income		**263.7**	220.3	**263.7**	220.3
Fee and commission income	7	**74.8**	88.7	**74.8**	88.7
Fee and commission expense	7	**(48.0)**	(47.8)	**(48.0)**	(47.8)
Net fee and commission income		**26.8**	40.9	**26.8**	40.9
Income from investments		**0.2**	0.2	**0.2**	0.2
Other operating income	8	**37.0**	60.6	**37.0**	60.6
Operating income		**327.7**	322.0	**327.7**	322.0
Operating expenses					
Operating expenses	9	**(532.9)**	(783.2)	**(532.9)**	(783.2)
Provision for customer redress	27	**(27.0)**	(22.4)	**(27.0)**	(22.4)
Total operating expenses		**(559.9)**	(805.6)	**(559.9)**	(805.6)
Operating losses before net impairment losses		**(232.2)**	(483.6)	**(232.2)**	(483.6)
Net impairment (losses)/gains on loans and advances	14	**(1.9)**	6.2	**(1.9)**	6.2
Operating loss before exceptional items		**(234.1)**	(477.4)	**(234.1)**	(477.4)
Gain on Restructuring and Recapitalisation	2.1	**397.8**	-	**7.4**	-
Gain on pension scheme modification	29	**51.9**	-	**51.9**	-
Operating gain/(loss) after exceptional items		**215.6**	(477.4)	**(174.8)**	(477.4)
Share of post-tax profits from joint ventures	31	**0.4**	0.3	**0.4**	0.3
Profit/(loss) before taxation		**216.0**	(477.1)	**(174.4)**	(477.1)
Income tax	11	**16.7**	58.4	**16.7**	58.4
Profit/(loss) for the financial year		**232.7**	(418.7)	**(157.7)**	(418.7)

The results above are for the consolidated Group and consolidated Bank. The comparative figures for these results are those of the consolidated Bank for the year ending 31 December 2016. More information regarding the basis of preparation can be found in note 1 to the consolidated financial statements.

The profit/(loss) for the financial year is wholly attributable to equity shareholders.

The notes on pages 118 to 174 form part of these financial statements.

Consolidated statement of comprehensive income
For the year ended 31 December 2017
All amounts are stated in £m unless otherwise indicated

	Group		Bank	
	2017	2016	**2017**	2016
Profit/(loss) for the year	**232.7**	(418.7)	**(157.7)**	(418.7)
Other comprehensive income that may be recycled to profit or loss:				
Changes in cash flow hedges:				
Net changes in fair value recognised directly in equity	**(44.3)**	11.1	**(44.3)**	11.1
Transfers from equity to income or expense	**9.0**	18.0	**9.0**	18.0
Taxation	**8.8**	(7.3)	**8.8**	(7.3)
Changes in available for sale assets:				
Net changes in fair value recognised directly in equity	**12.3**	80.8	**12.3**	80.8
Transfers from equity to income or expense	**(30.0)**	(100.7)	**(30.0)**	(100.7)
Taxation	**4.6**	2.5	**4.6**	2.5
Other comprehensive income that may not be recycled to profit or loss:				
Changes in net retirement benefit asset:				
Recognition of defined benefit asset	**-**	81.7	**-**	81.7
Defined benefit plan actuarial gains/(losses)	**81.6**	(68.4)	**81.6**	(68.4)
Taxation	**(20.3)**	(3.8)	**(20.3)**	(3.8)
Other comprehensive income for the financial year, net of income tax	**21.7**	13.9	**21.7**	13.9
Total comprehensive income/(expense) for the financial year	**254.4**	(404.8)	**(136.0)**	(404.8)

The results above are for the consolidated Group and consolidated Bank. The comparative figures for these results are those of the consolidated Bank for the year ending 31 December 2016. More information regarding the basis of preparation can be found in note 1 to the consolidated financial statements.

The notes on pages 118 to 174 form part of these financial statements.

Consolidated balance sheet
At 31 December 2017
All amounts are stated in £m unless otherwise indicated

		Group		Bank	
			Re-presented[1]		Re-presented[1]
	Note	**2017**	2016	**2017**	2016
Assets					
Cash and balances at central banks	12	**4,032.1**	2,848.2	**4,032.1**	2,848.2
Loans and advances to banks	13	**574.8**	658.3	**574.8**	658.3
Loans and advances to customers	14	**16,744.5**	19,452.7	**16,744.5**	19,452.7
Fair value adjustments for hedged risk		**70.3**	131.6	**70.3**	131.6
Investment securities - loans and receivables	15a	**100.0**	13.8	**100.0**	13.8
Investment securities - available for sale	15b	**2,287.7**	3,538.1	**2,287.7**	3,538.1
Derivative financial instruments	16	**232.4**	425.5	**232.4**	425.5
Property, plant and equipment classified as held for sale		**2.8**	5.3	**2.8**	5.3
Equity shares	17	**26.6**	46.8	**26.6**	46.8
Investments in joint ventures	31	**6.3**	6.0	**6.3**	6.0
Investment properties		**2.3**	2.2	**2.3**	2.2
Property, plant and equipment	19	**44.4**	35.4	**44.4**	35.4
Intangible assets	18	**81.5**	100.1	**81.5**	100.1
Other assets	20	**95.3**	96.7	**95.3**	96.7
Prepayments and accrued income	21	**24.7**	28.7	**24.7**	28.7
Current tax assets		**2.5**	-	**2.5**	-
Deferred tax assets	28	**4.2**	-	**4.2**	-
Net retirement benefit asset	29	**157.7**	20.3	**157.7**	20.3
Total assets		**24,490.1**	27,409.7	**24,490.1**	27,409.7
Liabilities					
Deposits by banks	22	**1,122.7**	1,020.0	**1,122.7**	1,020.0
Customer accounts		**20,635.0**	22,425.1	**20,635.1**	22,425.1
Customer accounts - capital bonds		**-**	11.8	**-**	11.8
Debt securities in issue	23	**627.4**	1,625.4	**627.4**	1,625.4
Derivative financial instruments	16	**315.0**	444.5	**315.0**	444.5
Other borrowed funds	24	**-**	472.6	**-**	472.6
Other liabilities	25	**34.7**	45.9	**34.7**	45.9
Accruals and deferred income	26	**80.0**	115.3	**80.0**	115.3
Provisions for liabilities and charges	27	**158.2**	276.4	**158.2**	276.4
Deferred tax liabilities	28	**0.2**	14.2	**0.2**	14.2
Net retirement benefit liability	29	**11.3**	-	**11.3**	-
Total liabilities		**22,984.5**	26,451.2	**22,984.6**	26,451.2
Capital and reserves attributable to the Group's and Bank's equity holders					
Ordinary share capital	33	**0.9**	22.6	**25.6**	22.6
Share premium account	33	**313.8**	1,736.9	**2,416.9**	1,736.9
Retained earnings		**(1,082.4)**	(1,315.1)	**(1,472.8)**	(1,315.1)
Available for sale reserve		**25.1**	38.2	**25.1**	38.2
Capital redemption reserve		**410.0**	410.0	**410.0**	410.0
Cash flow hedging reserve		**29.9**	56.4	**29.9**	56.4
Capital re-organisation reserve	2.1	**1,737.5**	-	**-**	-
Defined benefit pension reserve		**70.8**	9.5	**70.8**	9.5
Total equity		**1,505.6**	958.5	**1,505.5**	958.5
Total liabilities and equity		**24,490.1**	27,409.7	**24,490.1**	27,409.7

1. The comparative figures have been re-presented to more fairly reflect their nature. Further information can be found in notes 13 and 22 to the consolidated financial statements.

The results above are for the consolidated Group and consolidated Bank. The comparative figures for these results are those of the consolidated Bank for the year ending 31 December 2016.

More information regarding the basis of preparation can be found in note 1 to the consolidated financial statements.

The notes on pages 118 to 174 form part of these financial statements.

Approved by the Board for The Co-operative Bank Holdings Limited 13 March 2018:

Dennis Holt	Liam Coleman	Tom Wood
Chairman	Chief Executive Officer	Chief Financial and Restructuring Officer

Approved by the Board for The Co-operative Bank Plc 13 March 2018:

Dennis Holt	Liam Coleman	Tom Wood
Chairman	Chief Executive Officer	Chief Financial and Restructuring Officer

Consolidated statement of cash flows
For the year ended 31 December 2017
All amounts are stated in £m unless otherwise indicated

		Group		Bank	
			Re-presented[1]		Re-presented[1]
	Note	**2017**	2016	**2017**	2016
Cash flows from/(used in) operating activities:					
Profit/(loss) before taxation		**216.0**	(477.1)	**(174.4)**	(477.1)
Adjustments for:					
Gain on capital raise		**(397.8)**	-	**(7.4)**	-
Gain on pension scheme modification		**(51.9)**	-	**(51.9)**	-
Interest payable in respect of other borrowed funds		**25.4**	43.9	**25.4**	43.9
Effect of exchange rate movements		**(5.3)**	(8.2)	**(5.3)**	(8.2)
Fair value movement on investment properties		**(0.1)**	(0.2)	**(0.1)**	(0.2)
Impairment losses/(gains) on loans and advances		**1.9**	(6.2)	**1.9**	(6.2)
Fair value movement on loans and advances		**6.4**	8.1	**6.4**	8.1
Depreciation and amortisation		**35.4**	41.1	**35.4**	41.1
Impairment of intangible fixed assets		**3.1**	40.6	**3.1**	40.6
Interest amortisation		**1.8**	(12.6)	**1.8**	(12.6)
Fair value movements and amortisation of financial assets and liabilities		**35.0**	(82.2)	**35.0**	(82.2)
Gain on sale of equity shares		**(22.8)**	(58.1)	**(22.8)**	(58.1)
Profit on disposal of investment securities		**(6.3)**	(18.4)	**(6.3)**	(18.4)
Impairment of property, plant and equipment		**0.5**	0.5	**0.5**	0.5
Gain on disposal of property, plant, equipment and software		**(0.1)**	(4.8)	**(0.1)**	(4.8)
Loss on sale of loans and advances		**11.5**	7.2	**11.5**	7.2
Unwind of fair value adjustments arising on transfer of engagements		**60.6**	176.8	**60.6**	176.8
		(86.7)	(349.6)	**(86.7)**	(349.6)
Increase in deposits by banks		**102.7**	294.1	**102.7**	294.1
Decrease in prepayments and accrued income		**4.0**	14.8	**4.0**	14.8
Decrease in accruals and deferred income		**(35.3)**	(37.2)	**(35.3)**	(37.2)
Decrease in customer accounts and capital bonds		**(1,801.9)**	(372.5)	**(1,801.8)**	(372.5)
Decrease in debt securities in issue		**(1,056.9)**	(1,105.7)	**(1,056.9)**	(1,105.7)
Decrease in loans and advances to banks		**102.7**	169.6	**102.7**	169.6
Decrease in loans and advances to customers		**2,680.7**	239.7	**2,680.7**	239.7
Net movement of other assets and other liabilities		**28.1**	(81.2)	**28.0**	(81.2)
Income tax/group relief received		**4.0**	0.4	**4.0**	0.4
Net cash flows used in operating activities		**(58.6)**	(1,227.6)	**(58.6)**	(1,227.6)
Cash flows from/(used in) investing activities:					
Purchase of tangible and intangible fixed assets		**(43.1)**	(39.7)	**(43.1)**	(39.7)
Proceeds from sale of property, plant and equipment		**8.5**	12.0	**8.5**	12.0
Proceeds from sale of investment property		**-**	0.1	**-**	0.1
Proceeds from the sale of equity shares		**25.3**	41.8	**25.3**	41.8
Purchase of investment securities		**(408.1)**	(363.7)	**(408.1)**	(363.7)
Proceeds from sale and maturity of investment securities		**1,528.0**	1,747.6	**1,528.0**	1,747.6
Net cash flows from investing activities		**1,110.6**	1,398.1	**1,110.6**	1,398.1
Cash flows from/(used in) financing activities:					
Interest paid on other borrowed funds		**(29.3)**	(43.9)	**(29.3)**	(43.9)
Net cash raised through Restructuring and Recapitalisation		**180.4**	-	**180.4**	-
Net cash flows from/(used in) financing activities		**151.1**	(43.9)	**151.1**	(43.9)
Net increase in cash and cash equivalents		**1,203.1**	126.6	**1,203.1**	126.6
Cash and cash equivalents at the beginning of the financial year		**3,266.3**	3,139.7	**3,266.3**	3,139.7
Cash and cash equivalents at the end of the financial year		**4,469.4**	3,266.3	**4,469.4**	3,266.3
Cash and balances with central banks	12	**3,994.5**	2,807.2	**3,994.5**	2,807.2
Loans and advances to banks	13	**474.9**	459.1	**474.9**	459.1
		4,469.4	3,266.3	**4,469.4**	3,266.3

Reconciliation of movements of liabilities to cash flows arising from financing activities

	Group					
	Deposits by banks	Customer accounts	Customer accounts – capital bonds	Debt securities in issue	Derivate financial instrument liabilities	Other borrowed funds
Balance at 1 January 2017 re-presented[1]	**1,020.0**	**22,425.1**	**11.8**	**1,625.4**	**444.5**	**472.6**
Changes from financing cash flows						
Interest paid on other borrowed funds	-	-	-	-	-	**(29.3)**
Total changes from financing cash flows	**-**	**-**	**-**	**-**	**-**	**(29.3)**
Other changes						
Movement in deposits by banks	**102.7**	**-**	**-**	**-**	**-**	**-**
Movement in debt securities in issue	**-**	**-**	**-**	**(998.0)**	**-**	**-**
Net movement in other liabilities	**-**	**(1,790.1)**	**(11.8)**	**-**	**(129.5)**	**-**
Debt restructuring as part of capital raise	**-**	**-**	**-**	**-**	**-**	**(468.7)**
Interest payable on other borrowed funds	**-**	**-**	**-**	**-**	**-**	**25.4**
Balance at 31 December 2017	**1,122.7**	**20,635.0**	**-**	**627.4**	**315.0**	**-**

	Bank					
	Deposits by banks	Customer accounts	Customer accounts – capital bonds	Debt securities in issue	Derivate financial instrument liabilities	Other borrowed funds
Balance at 1 January 2017 re-presented[1]	**1,020.0**	**22,425.1**	**11.8**	**1,625.4**	**444.5**	**472.6**
Changes from financing cash flows						
Interest paid on other borrowed funds	-	-	-	-	-	**(29.3)**
Total changes from financing cash flows	**-**	**-**	**-**	**-**	**-**	**(29.3)**
Other changes						
Movement in deposits by banks	**102.7**	**-**	**-**	**-**	**-**	**-**
Movement in debt securities in issue	**-**	**-**	**-**	**(998.0)**	**-**	**-**
Net movement in other liabilities	**-**	**(1,790.0)**	**(11.8)**	**-**	**(129.5)**	**-**
Debt restructuring as part of capital raise	**-**	**-**	**-**	**-**	**-**	**(468.7)**
Interest payable on other borrowed funds	**-**	**-**	**-**	**-**	**-**	**25.4**
Balance at 31 December 2017	**1,122.7**	**20,635.1**	**-**	**627.4**	**315.0**	**-**

1. The comparative figures have been re-presented in order to separately analyse the gain on sale of equity shares to more fairly reflect the nature of the balances, and the obligatory netting arrangements in place relating to repo and reverse repo transactions. Further information on the netting arrangements can be found in notes 13 and 22 to the consolidated financial statements.

The results above are for the consolidated Group and consolidated Bank. The comparative figures for these results are those of the consolidated Bank for the year ending 31 December 2016. More information regarding the basis of preparation can be found in note 1 to the consolidated financial statements.

The notes on pages 118 to 174 form part of these financial statements.

Consolidated statement of changes in equity
For the year ended 31 December 2017
All amounts are stated in £m unless otherwise indicated

Following the completion of the Restructuring and Recapitalisation and the creation of The Co-operative Bank Holdings Limited, share capital in the current year reflects the Group position. The comparative reflects the consolidated Bank position.

	Attributable to equity holders of the Group								
	Share capital	**Share premium**	**Available for sale reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Capital reorganisation reserve**	**Defined benefit pension reserve**	**Retained earnings**	**Total equity**
2017									
Balance at the beginning of the year	**22.6**	**1,736.9**	**38.2**	**56.4**	**410.0**	**-**	**9.5**	**(1,315.1)**	**958.5**
Total comprehensive (expense)/income for the year	**-**	**-**	**(13.1)**	**(26.5)**	**-**	**-**	**61.3**	**232.7**	**254.4**
Issuance of share capital and Group restructure	**(21.7)**	**(1,423.1)**	**-**	**-**	**-**	**1,737.5**	**-**	**-**	**292.7**
Balance at the end of the year	**0.9**	**313.8**	**25.1**	**29.9**	**410.0**	**1,737.5**	**70.8**	**(1,082.4)**	**1,505.6**

	Attributable to equity holders of the Bank							
	Share capital	**Share premium**	**Available for sale reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Defined benefit pension reserve**	**Retained earnings**	**Total equity**
2017								
Balance at the beginning of the year	**22.6**	**1,736.9**	**38.2**	**56.4**	**410.0**	**9.5**	**(1,315.1)**	**958.5**
Total comprehensive (expense)/ income for the year	**-**	**-**	**(13.1)**	**(26.5)**	**-**	**61.3**	**(157.7)**	**(136.0)**
Issuance of share capital	**3.0**	**680.0**	**-**	**-**	**-**	**-**	**-**	**683.0**
Balance at the end of the year	**25.6**	**2,416.9**	**25.1**	**29.9**	**410.0**	**70.8**	**(1,472.8)**	**1,505.5**

	Attributable to equity holders of the Group and Bank							
	Share capital	Share premium	Available for sale reserve	Cash flow hedging reserve	Capital redemption reserve	Defined benefit pension reserve	Retained earnings	Total equity
2016								
Balance at the beginning of the year	22.6	1,736.9	55.6	34.6	410.0	-	(896.4)	1,363.3
Total comprehensive (expense)/ income for the year	-	-	(17.4)	21.8	-	9.5	(418.7)	(404.8)
Balance at the end of the year	22.6	1,736.9	38.2	56.4	410.0	9.5	(1,315.1)	958.5

The results above are for the consolidated Group and consolidated Bank. The comparative figures for these results are those of the consolidated Bank for the year ending 31 December 2016. More information regarding the basis of preparation can be found in note 1 to the consolidated financial statements.

The notes on pages 118 to 174 form part of these financial statements.

1. Basis of preparation and significant accounting policies

The accounting policies referred to as applicable to the Group are equally applicable to the Bank.

1.1 Basis of preparation

The Co-operative Bank Holdings Limited (Holding Company) is incorporated in the UK and registered in England and Wales. On 1 September 2017, the Holding Company became the new Holding Company for The Co-operative Bank plc (Bank) and its subsidiaries by way of a share for share exchange. On the basis that the transaction was effected by creating a new parent that is itself not a business, the transaction is considered to be outside the scope of IFRS 3 (Business Combinations). It has therefore been accounted for using the pooling of interest method as a continuation of the existing group. The 2017 consolidated results for the Group comprise the results of the Bank Company and its subsidiaries from 1 January 2017 to 31 August 2017 and of the Holding Company and its subsidiaries from 1 September 2017 to 31 December 2017. The comparative figures provided for these results are those of the consolidated Bank and its subsidiaries (the Bank) for the year ending 31 December 2016.

Consolidated results for the year ending 31 December 2017 for the Bank are also presented. The comparative figures for these results are those of the Bank for the year ending 31 December 2016.

All the notes within these financial statements have been prepared on a Group basis, however they are equally applicable to the Bank. Where differences arise this is explicitly stated.

Each of the Holding Company, Bank Company, Group and Bank financial statements have been prepared and approved by the Directors of the respective companies in accordance with IFRS as issued by the International Accounting Standards Board (IASB), and as adopted by the European Union (EU).

On including the Parent Company financial statements within the Group's and Bank's Annual Report and Accounts, the Holding Company and Bank Company are taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present their individual income statements and related notes that form a part of these approved financial statements.

The financial statements have been prepared under the historic cost convention as modified by the revaluation of available for sale (AFS) financial assets, derivative contracts, investment properties and certain other financial assets and financial liabilities held at fair value. The recognition, measurement and disclosure requirements of IFRS in issue that are endorsed by the EU and are effective are applied for accounting periods beginning on or after 1 January 2017. The financial statements comprise all audited sections of the accounts. Where indicated, the risk management section forms part of the audited accounts.

Accounting policies and the requirements of IFRS in issue that are endorsed by the EU and effective for periods on or after 1 January 2017 apply to both the Group and the Bank.

1.1.1 Standards and interpretations issued and effective

During 2017, the following amendments to International Accounting Standards (IAS) and interpretations were adopted:

- Amendments to IAS 7 (Statement of Cash Flows)
  The amendments require disclosure of information enabling users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments do not define financing activities, instead they clarify that financing activities are based on the existing definition used in IAS 7. The amendments have had no material impact on the 2017 financial statements.

- Amendments to IAS 12 (Income Taxes)
  These amendments on the recognition of deferred tax assets for unrealised losses clarify how to account for deferred tax assets related to debt instruments measured at fair value. The amendments have had no material impact on the 2017 financial statements.

1.1.2 Standards and interpretations issued but not yet effective

At the date of authorisation of these financial statements, the following new and revised IFRSs, that have been issued, but are not yet effective and, in some cases, not yet adopted by the EU, have not been applied.

- **IFRS 9 (Financial Instruments)**
  In July 2014, the IASB issued IFRS 9 (Financial Instruments), which is the comprehensive standard to replace IAS 39 (Financial Instruments: Recognition and Measurement) and is effective for periods beginning on or after 1 January 2018, and was endorsed by the EU on 22 November 2016. IFRS 9 includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

Classification and Measurement (C&M)

i. Overview

From 1 January 2018 under IFRS 9, financial assets (excluding derivatives) are classified as:

- amortised cost;
- fair value through other comprehensive income (FVOCI); or
- fair value through profit or loss (FVTPL).

ii. Debt instruments

Debt instruments are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. Unless designated at FVTPL under IFRS 9, the classification and subsequent measurement of debt instruments are based on:

- the business model for managing the debt instruments; and
- the contractual cash flows of the debt instruments.

The business model for managing the debt instruments - The business models reflect how financial assets are managed in order to generate cash flows. These business models determine whether cash flows will result from collecting contractual cash flows, selling financial assets or both. Factors considered in determining the business model for a group of assets include both past experience and future plans for these assets. The IFRS 9 business models (which are distinct from the definition under IFRS 8 operating segments) were determined on 1 January 2018 with reference to how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how senior managers are compensated.

The contractual cash flows of the debt instruments - In determining the classification of a financial asset, it is determined whether the financial asset's cash flows represent solely payments of principal and interest (the SPPI test). Payments of principal and interest are solely those consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risk (including liquidity risk), costs (including administrative costs) and a profit margin that is consistent with a basic lending arrangement. If the SPPI test is not passed, then the related financial asset is measured at fair value through profit or loss.

Debt instruments are classified at:

- amortised cost if the SPPI test is passed and the business model for managing the asset is of hold to collect;
- FVOCI if the SPPI test is passed and the business model for managing the asset is of hold to collect and sell; or
- FVTPL if the SPPI test is failed or if the business model for managing the asset is not one of hold to collect or hold to collect and sell.

iii. Other financial instruments

All equity instruments are measured at FVTPL as an election has not been made to designate equity instruments, on an instrument by instrument basis, at FVOCI as at 1 January 2018. Financial liabilities are classified at amortised cost under IFRS 9. All derivative assets and liabilities not in a hedge relationship are measured at FVTPL under IFRS 9.

iv. C&M impact assessment on transition

The application of the IFRS 9 C&M rules is estimated to decrease total equity by £2.0m as at 1 January 2018, net of deferred tax. This decrease is principally due to the reclassification of the surrendered loss debtor from amortised cost to FVTPL. The table below summarises the C&M changes on transition to IFRS 9.

Financial Instrument	IAS 39	IFRS 9
Equity shares	AFS	FVTPL
Warwick Finance Three residual interest	AFS	FVTPL
Surrendered loss debtor	Amortised cost	FVTPL
Other AFS Treasury instruments	AFS	FVOCI
Other loans and receivables	Loans and receivables	Amortised cost

The estimated impact is based on accounting policies, assumptions, judgements and estimation techniques that remain subject to change until the finalisation of the 2018 Annual Report and Accounts.

Impairment

From 1 January 2018 under IFRS 9, the expected credit loss (ECL) is assessed on a forward-looking basis for debt instruments carried at amortised cost and FVOCI, for exposures related to loan commitments, and for financial guarantee contracts. Under IFRS 9, a loss allowance for such losses is recognised, reflecting:

- an unbiased and probability weighted amount that was determined by evaluating a range of possible outcomes;
- the time value of money; and
- reasonable and supportable information that was available without undue cost or effort at the reporting date about past events, current conditions and forecasts of economic data.

Credit risk is measured using probability of default (PD), loss given default (LGD) and exposure at default (EAD).

The IFRS 9 3 stage approach to model ECL is applied:

Stage 1 Initial recognition	Stage 2 Significant increase in credit risk	Stage 3 Credit impaired
12 month ECL	Lifetime ECL	

Financial instruments are classified within stage 1 on initial recognition. If a significant increase in credit risk (SICR) since recognition is identified but the financial instrument is not credit impaired, then the financial instrument transitions to stage 2. A financial instrument transitions to stage 3 when it becomes credit impaired.

Financial instruments within stage 1 have a loss allowance reflecting a 12 month ECL whereas financial instruments within stage 2 and 3 have a loss allowance reflecting a lifetime ECL. Financial instruments which are purchased or originated credit impaired (POCI) attract a lifetime ECL until derecognition irrespective of staging criteria. For stage 3 assets, interest is recorded on a net basis.

i) Constitution of the expected credit loss provision

The ECL provision is calculated based on collective and individual assessments. Post model adjustments (expert overlays) are applied to reflect risk characteristics for assets subject to collective provisioning but for which a specific risk characteristic is not captured within the collective models.

ii) Significant increase in credit risk

A financial instrument is considered to have experienced a significant increase in credit risk since initial recognition when one or more quantitative or qualitative or backstop criteria have been met. The quantitative criterion is a PD based measure, with a backstop of 30 days past due. Qualitative drivers of a significant increase in credit risk include exposures determined to be higher risk and subject to closer credit risk monitoring.

iii) Definition of default and credit impaired financial instruments

The definition of default is set out below:

Portfolio	Quantitative criteria	Qualitative criteria*
Retail secured and Optimum	180 days past due	• Bankrupt and 30 days overdue • Fraud • Litigation/possession • Term expiry • Certain types of forbearance and unlikeliness to pay factors
Retail unsecured	90 days past due	• Bankruptcy • Certain types of forbearance and unlikeliness to pay factors
Legacy portfolio and BaCB	90 days past due	• Insolvency • Certain types of forbearance and unlikeliness to pay factors
Treasury	90 days past due	• Insolvency

The criteria above are aligned with the definition of default used for credit risk management practices and for regulatory capital reporting purposes. The default definition is applied consistently throughout the ECL calculation within the PD, LGD and EAD models.

The presumption within IFRS 9 that Retail secured and Optimum loans which are more than 90 days past due are allocated to stage 3 has been rebutted and a quantitative backstop of 180 days past due has been applied. 180 days past due is considered a more appropriate criterion for determining default as 180 days past due is used internally for internal credit risk management and regulatory purposes. Analysis has been performed which shows that 180 days past due is a more appropriate default definition for the Retail secured portfolio.

If an instrument does not meet the default criteria for a defined period of months (after a probationary period of 6-12 months) then an instrument is no longer considered in default. This period has been set with regard to the probability of an instrument returning to default status after cure.

iv) Calculation of the ECL

The ECL is calculated as the discounted multiple of the Probability of Default (PD) * the Exposure at Default (EAD) * Loss Given Default (LGD). PD, EAD and LGD are all based on historical analysis, adjusted for the future view of forward-looking macroeconomic information. See v) below for an explanation of how forward-looking information is included in ECL calculations.

	Definition
Probability of Default	The likelihood of a borrower defaulting as defined in iii) above, either on a 12 month PD for stage 1 assets or on a lifetime PD for stage 2 and 3 assets.
Exposure At Default	EAD is the amount expected to be owed at the time of default.
Loss Given Default	LGD represents the expectation of the extent of loss on a defaulted exposure.

The lifetime ECL is calculated by projecting the PD, EAD and LGD for each future quarter and for each individual exposure or collective segment, adjusted for the likelihood of default in earlier quarters, discounted back to the reporting date. The 12 month ECL is calculated in the same way as the lifetime ECL, with exception that the calculation only includes losses from default events occurring in the 12 months following the balance sheet date. The discount rate applied is the Effective Interest Rate (EIR).

v) Incorporation of forward-looking information
Both the assessment for SICR and the calculation of ECL incorporate forward-looking information. Historical analysis has been performed to identify the key economic variables impacting credit risk and expected credit losses by portfolio. Regression analysis was performed to determine which economic variables are key to individual portfolios. Forecasts of key economic variables reflecting the economic scenarios are provided by an internal economics team on a regular basis. The economics team sources economic scenarios from a third party and makes adjustments if necessary prior to approval via internal governance processes.

In order to capture non linearities and asymmetries within the ECL calculation, a number of possible scenarios, together with their weightings, are obtained from the internal economics team. The number of scenarios and their weightings are assessed on an annual basis (subject to any interim salient economic events). By considering statistical analysis and applying expert credit judgement, it has been determined that one upside and one downside scenario in addition to the base scenario are required.

The assessment of SICR is performed using the remaining lifetime PD under each scenario, multiplied by the scenario weighting, along with the qualitative and backstop indicators set out in ii) above. This assessment determines whether the whole financial instrument should be in stage 1, 2 or 3 and hence whether a 12 month or a lifetime expected credit loss should be recognised. Following this assessment the ECL is measured as either a probability weighted 12 month ECL (stage 1) or a probability weighted lifetime ECL (stage 2 or 3). The probability weighted ECLs are calculated by applying each scenario to the ECL models and multiplying the result by the respective scenario weighting.

vi) Segmentation of portfolios
Financial assets are grouped together where ECL calculations are performed on a collective basis. Regression analysis has been performed to determine how financial assets should be grouped such that risk characteristics of assets within a group are homogeneous and the risk characteristics of each group are statistically significant to another.

vii) Impact assessment on transition to IFRS 9 impairment on 1 January 2018
Adoption of the impairment requirements of IFRS 9 on 1 January 2018 is estimated to decrease total equity within a range of £5m to £13m, net of deferred tax. The estimated impact is based on accounting policies, assumptions, judgements and estimation techniques that remain subject to change until the finalisation of the 2018 Annual Report and Accounts. The increase in the total level of impairment under IFRS 9 is principally as a result of:

- all financial assets, not at fair value through profit and loss, being assessed for at least 12-month ECL which was not the case for all financial assets under IAS 39;
- the population of financial assets to which lifetime ECL applies is larger than the population for which there is objective evidence of impairment in accordance with IAS 39 for some portfolios (including the lifetime ECL impairment of purchased or originated credit impaired financial instruments); and
- the inclusion of assumptions regarding the drawdown of credit commitments as part of ECL calculations.

Hedge accounting
An election has been made to remain with IAS 39 for hedge accounting from 1 January 2018.

Comparative information
Comparative information will not be restated on initial adoption of IFRS 9 on 1 January 2018.

Governance
Accounting policy and other key judgements made as part of IFRS 9 implementation are, and will continue to be, subject to appropriate governance within both Risk and Finance as appropriate.

- **IFRS 15 (Revenue from contracts with customers)**
  IFRS 15 is the new revenue standard, superseding the previous revenue recognition standard (IAS 18) and construction contracts (IAS 11). IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied.

  The standard is effective from 1 January 2018 and has been endorsed by the EU. The amendments have been considered and the effects of IFRS 15 are deemed to be immaterial, as the majority of income is recognised in accordance with IAS 39 (Financial Instruments: Recognition and Measurement).

  The standard requires retrospective application being either ‘full retrospective’ or ‘modified retrospective’ adoption, both with practical expedients. The modified retrospective approach is considered to be appropriate.

Modified retrospective adoption

IFRS 15 will be applied to contracts that are not yet completed at the date of initial application, being 1 January 2018. A completed contract is one where all the goods and services have been transferred to the customer, even if the consideration has not yet been received. Contracts that have not completed before 1 January 2018 are to be evaluated as if IFRS 15 has always applied, regardless of when those contracts commenced. Under this approach:

- comparative periods (2017) in accordance with prior revenue standards (i.e. IAS 18) will be presented;
- IFRS 15 will be applied to new and existing contracts (that haven't completed) from 1 January 2018, where applicable; and
- a cumulative catch up adjustment will be recognised in opening retained earnings (i.e. 1 January 2018) for existing contracts that still require performance in 2018, disclosing the amount for each financial statement line item affected by applying IFRS 15 and an explanation of significant changes.

1.1.3 Other standards

- **Amendments to IFRS 10 (Consolidated Financial Statements) and IAS 28 (Investments in Associates and Joint Ventures (2014))**

  These amendments address an inconsistency between the requirements in IFRS 10 and those in IAS 28 in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognised when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

  The amendment is effective for reporting periods beginning on or after 1 January 2018 but is available for early adoption subject to EU endorsement. The impact is likely to be immaterial.

- **IFRS 16 (Leases)**

  The IASB has published a new standard, IFRS 16 (Leases). The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained.

  IFRS 16 supersedes IAS 17 (Leases) and related interpretations and is effective for periods beginning on or after 1 January 2019, with earlier adoption permitted if IFRS 15 (Revenue from Contracts with Customers) has also been applied. The impact of the new standard has not yet been quantified.

- **Amendments to IFRS 2 (Share-based Payment)**

  This amendment clarifies the measurement basis for cash-settled, share-based payments and the accounting for modifications that change an award from cash-settled to equity-settled. It also introduces an exception to the principles in IFRS 2 that will require an award to be treated as if it was wholly equity-settled, where an employer is obliged to withhold an amount for the employee's tax obligation associated with a share-based payment and pay that amount to the tax authority.

  The amendment is effective for reporting periods beginning on or after 1 January 2018 but is available for early adoption subject to EU endorsement. The impact is considered to be immaterial.

- **Amendments to IAS 40 (Investment Property)**

  The amendments clarify that transfers to, or from, investment property can only be made if there has been a change in use that is supported by evidence. A change in use occurs when the property meets, or ceases to meet, the definition of investment property. A change in intention alone is not sufficient to support a transfer.

  The amendment is effective for reporting periods beginning on or after 1 January 2018 but is available for early adoption subject to EU endorsement. The impact of the amendments is considered to be immaterial.

- **International Financial Reporting Interpretations Committee (IFRIC) 22 (Foreign Currency Transactions and Advance Consideration)**

  The interpretation clarifies how to determine the date of transaction for the exchange rate to be used on initial recognition of a related asset, expense or income where an entity pays or receives consideration in advance for foreign currency denominated contracts. For a single payment or receipt, the date of the transaction should be the date on which the entity initially recognises the non-monetary asset or liability arising from the advance consideration (the prepayment or deferred income/contract liability).

  The amendment is effective for reporting periods beginning on or after 1 January 2018 but is available for early adoption subject to EU endorsement. The impact of the amendments is considered to be immaterial.

- **IFRIC 23 (Uncertainty over Income Tax Treatments)**

  The interpretation is to be applied to the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12 (Income Taxes).

  The amendment is effective for reporting periods beginning on or after 1 January 2019 but is available for early adoption subject to EU endorsement. The impact of the amendments has not yet been quantified.

  Other standards and interpretations have been issued but these are not considered to be relevant to underlying operations. The intention is to comply with the standards from the date they become effective.

1.2 Going concern

IAS 1 (Presentation of Financial Statements) requires Directors to make an assessment of a company's ability to adopt the going concern basis of accounting in the future. IAS 1 states that the information should cover at least 12 months from the end of the reporting period but not be limited to that period. Financial Reporting Council (FRC) guidelines state that the information should consider a period of at least 12 months from the date the financial statements are authorised for issue. This assessment is required at both a Co-operative Bank Holdings Limited (Group) and Co-operative Bank plc (Bank) level.

When considering the going concern status of the Group and the Bank, the Directors have referenced the FRC published guidance on the going concern Basis of Accounting and Reporting on Solvency and Liquidity Risks (the 2016 Guidance). The 2016 Guidance is specifically intended for Directors of companies that do not apply the UK Corporate Governance Code. The 2016 Guidance brings together the requirements of company law, accounting standards, auditing standards, other regulation and existing FRC guidance relating to reporting on the going concern basis of accounting and solvency and liquidity risks. It provides application guidance in addition to including principles for best practice and practical examples.

The Group has recently approved its 2018-2022 Financial Plan (the Plan) and has used this as the basis of its assessment in evaluating whether adopting the going concern basis of accounting is appropriate. This includes a detailed review of projected profitability, forecast liquidity position, capital adequacy ratios and regulatory capital considerations. The Directors' assessment also included a consideration of the key uncertainties as disclosed in the 2016 Annual Report and Accounts and the progress made across 2017 in reducing the level of uncertainty involved. Specifically, the following key uncertainties were considered:

	2016 Key Uncertainty	2017 Progress
1)	Sale of the Bank / Recapitalisation	Successful delivery of Restructuring and Recapitalisation in September 2017 which eliminated this uncertainty and significantly increased capital resources.
2)	The Regulators' continued acceptance of the inability to meet regulatory requirements including CRR, ICG and combined buffer requirements	ICG and combined buffer compliance has been delivered at the end of 2017 which, based on the Plan, is expected to endure, due to both increased capital resources and reductions in capital requirements. The reduction in Pillar 2a requirements is primarily a result of the removal of the model risk component of Pillar 2a, due to progress made towards CRR compliance and a reduction in pension risk, due to progress made with regards to Pace sectionalisation. Although significant progress has been made towards CRR compliance there remains a risk that if CRR IRB non-compliance is not addressed it could potentially result in further regulatory action such as the permission to use an IRB approach being removed or a re-imposition of a capital add-on leading to a material increase in the calculation of minimum Pillar 1 regulatory capital requirements, which could impact on the going concern status. The Directors do not consider this outcome to be likely given the progress made towards achieving compliance.
3)	Negative impact on the brand and reputation of the Bank as a result of sale and restructure activity result in a negative impact on future performance	The Directors do not believe there has been a material impact to the Bank's brand or reputation following the conclusion of the Restructuring and Recapitalisation. Net mortgage lending increased and customer liabilities remained stable in H2 2017.
4)	Inability to issue MREL debt instruments could lead to a detrimental action from the PRA and/or the Bank of England	Given the surplus over regulatory capital requirements the ability to issue MREL eligible debt instruments has improved. As a result the uncertainty has been significantly reduced in 2017.
5)	Likelihood of delivering Pace sectionalisation	As Pace is not yet sectionalised and continues to operate on a 'last man standing' basis there is a risk that in the event that other participating employers become insolvent and the full statutory debt is not recovered on insolvency, the Group could become liable for the remaining liabilities. The Directors' performed an assessment of the financial strength of Co-operative Group Limited and concluded that there was low risk in this regard in the foreseeable future. The progress made with Pace sectionalisation is reflected in the reduction in Pillar 2a capital requirements as discussed in point 2 above.
6)	Material deviation from planned timescales and costs with regard to transformation, remediation and change programmes	Progress has been made across 2017 in relation to transformation, remediation and change programmes, including data centre migration and branch transformation projects. The Plan contains future actions which could materially deviate from planned timescales and costs; however, given the improvement of the Group's regulatory capital position the Directors' consider the ability to absorb any such unexpected events to be materially improved, and so this uncertainty is now significantly reduced.

Appropriate consideration has also been given to other key milestones delivered across 2017 that impact on the going concern assessment, such as the further deleverage of the Group's Optimum portfolio.

After considering the matters above, as well as the principal risks and uncertainties on pages 70 to 75, the Directors have a reasonable expectation that both the Group and the Bank will continue in operational existence for at least the next 12 months. Accordingly, the results for the full year ended 31 December 2017 have been prepared on a going concern basis.

1.3 Significant accounting policies

The accounting policies set out below have been applied consistently to all periods, inclusive of assets recognised where the Group and the Bank is subject to the substantial risks and rewards of those assets.

1.3.1 Basis of consolidation

a) Subsidiaries

Subsidiaries are all entities (including structured entities) controlled by the Holding Company or Bank Company. Control exists whenever the Holding Company or Bank Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity, in accordance with the requirements of IFRS 10 (Consolidated Financial Statements). In assessing control, potential voting rights that presently are exercisable are taken into account. The financial information of subsidiaries is included in the consolidated financial information from the date that control commences until the date that control ceases.

The financial information has been prepared using uniform accounting policies and is based on the same accounting period as the consolidated financial information of the Group and Bank. Intra-group balances and transactions, and any unrealised gains and losses arising from intra-group transactions, are eliminated in preparing the consolidated financial information.

Special Purpose Entities (SPEs) are entities that are created to accomplish a narrow and well defined objective; this includes:

- various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Bank Company; and
- covered Bond Limited Liability Partnership created in order to act as a guarantor for the issue of covered bonds.

An SPE is consolidated if, based on an evaluation of the substance of its relationship under IFRS 10 considerations, the Holding Company or Bank Company concludes that it controls the SPE.

The following circumstances may indicate a relationship in which, in substance, the Holding Company or Bank Company controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the Holding Company or Bank Company according to its specific business needs so that benefits are obtained from the SPE's operation;
- the Holding Company or Bank Company has the decision making powers to obtain the majority of the benefits of the activities of the SPE;
- the Holding Company or Bank Company has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to the risks incidental to the activities of the SPE; or
- the Holding Company or Bank Company retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The assessment of whether there is control over an SPE is carried out at inception. A reassessment of whether there is control over an SPE is performed at the end of each year.

b) Interests in joint ventures

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Interests in joint ventures are accounted for using the equity method. The consolidated financial information includes the proportionate share of the income and expenses and equity movements of equity accounted investees, after adjustments to align the accounting policies.

c) Interests in unconsolidated structured entities

Unconsolidated structured entities are unconsolidated entities that have been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity. Structured entities are not consolidated where it is determined with due regard to the variable returns from the structured entity and the ability to affect those returns, that the structured entity is not controlled under IFRS 10 (Consolidated Financial Statements) considerations. The Group acts as a sponsor for certain unconsolidated securitisation vehicle holding companies which it neither owns nor controls. The Group has determined itself a sponsor of unconsolidated securitisation vehicle companies if it does not have a material ongoing interest in the entity, but it may act to protect its reputation in relation to the structured entity.

1.3.2 Revenue recognition

a) Interest income and expense

Interest income and expense is recognised on an effective interest rate (EIR) basis, inclusive of directly attributable origination and incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate.

The EIR basis spreads the interest income and expense over the expected life of each instrument. The EIR is the rate that, at the inception of the instrument, exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating the EIR, the Bank estimates cash flows considering all contractual terms of the instrument (for example, prepayment options) but does not consider assets' future credit losses except for assets acquired at a deep discount.

For assets acquired at a value significantly below the carrying value in the acquiree's financial information because they have incurred loss, expectations of future loss are higher than at origination, and interest spreads have widened because of deteriorating market conditions, the calculation of EIR is the same as shown above with the exception that the estimates of future cash flows include incurred credit losses.

When an instrument is impaired, the carrying amount is reduced based on the revised cash flows, discounted at the original EIR of the instrument, and continues unwinding the discount as interest income.

Early redemption charges are recognised on a cash basis as received, as it is not possible to reliably estimate the receipt of such fees.

b) Fees and commissions

Fee and commission income is predominantly made up of arrangement and other fees relating to loans and advances to customers that are included in the EIR calculation.

Commitment fees received are deferred and included in the EIR calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

All other fee and commission income, such as loan closure fees or arrears fees, ATM fees and charges, current account and payments fees and charges, not included in the EIR calculation, are recognised on an accruals basis as the service is provided.

Fees and commissions payable to introducers in respect of obtaining lending business, where these are direct and incremental costs related to the issue of a financial instrument, are included in interest income as part of the effective interest rate.

c) Dividend income

Dividend income is recognised when the right to receive the payment is established, which is generally when the Directors approve the dividend as final. Interim dividends are recognised when the dividend is paid.

1.3.3 Financial instruments (excluding derivatives)

a) Recognition

Financial assets are recognised in the balance sheet when the Group becomes party to the contractual provisions of the instrument. Loans and advances are initially recognised when they are advanced to customers. Deposits, debt securities issued and other borrowed funds are recognised on the date at which they are originated. Regular way purchases and sales of financial assets are recognised on the trade date at which the commitment to purchase or sell the asset is made.

b) Derecognition

A financial asset is derecognised when the contractual rights to the cash flows from the financial assets expire, or it transfers the rights to receive the contractual cash flows in a transaction in which all the risks and rewards of ownership occurs. If neither transfer nor retention of substantially all the risks and rewards of ownership, and control of the transferred asset continues, the retained interest in the asset and an associated liability for amounts it may have to pay is recognised. A substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) is accounted for as an extinguishment of the original financial liability and a recognition of a new financial liability.

When a financial asset is derecognised in its entirety, the difference between the carrying amount and the sum of the consideration received (including any new asset obtained less any new liability assumed) is recognised in the income statement.

When available for sale financial assets are derecognised, the cumulative gain or loss, including that previously recognised in other comprehensive income, is recognised in the income statement.

A financial liability is derecognised when the obligation is discharged, cancelled or expires. Any difference between the carrying amount of a financial liability derecognised and the consideration paid is recognised through the income statement.

c) Financial assets

i. Overview

Financial assets (excluding derivatives) are classified as:

- loans and receivables;
- available for sale; or
- financial assets at fair value through profit or loss.

ii. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and there is no intention to sell immediately or in the near term. These are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. Subsequently, these are measured at amortised cost using the EIR method. The amortised cost is the amount advanced less principal repayments, plus the cumulative amortisation using the EIR method of any difference between the amount advanced and the maturity amount less impairment provisions for incurred losses.

Loans and receivables mainly comprise loans and advances to banks and customers (except where the election to carry the loans and advances to customers at fair value through profit or loss as described in accounting policy 1.3.3.c) iv. below is made).

There are a number of facility agreements with multiple counterparties, which form a single contractual relationship. These arrangements are considered to be single financial instruments and accounted for accordingly within loans and advances to customers, or customer deposits respectively.

Loans and receivables include RMBS measured at amortised cost, being a 5% regulatory holding of the Warwick Finance Three unconsolidated structured entity.

iii. Available for sale
Available for sale financial assets are debt securities and equity shares quoted in an active market and not accounted for at fair value through profit or loss. These are initially recognised on their trade date, measured at fair value based on current bid prices where quoted in an active market. Where the debt securities and equity shares are unlisted the fair values are based on valuation techniques including discounted cash flow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Movements in fair value are recorded in equity as they occur. On disposal, gains and losses recognised previously in equity are transferred to the income statement.

Available for sale financial assets include RMBS representing the interest in unconsolidated structured entities.

iv. Financial assets at fair value through profit or loss
Financial assets designated at fair value are assets which have been designated to eliminate or significantly reduce a measurement inconsistency or where management specifically manages an asset or liability on that basis, e.g. corporate loans to customers.

These assets are measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the securities are unlisted the fair values are based on valuation techniques including discounted cash flow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Gains and losses arising from changes in the fair value are brought into the income statement within other operating income as they arise.

d) Financial liabilities
Financial liabilities are contractual obligations to deliver cash or another financial asset. Financial liabilities are recognised initially at fair value, net of directly attributable transaction costs.

Financial liabilities, other than derivatives, are subsequently measured at amortised cost. Derivative financial liabilities are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in the income statement immediately unless the derivative is designated and effective as a hedging instrument in a cash flow hedge. See 'Derivative financial instruments and hedge accounting' policy for more detail.

1.3.4 Impairment provisions
a) Assessment
i. Objective evidence
At the balance sheet date, an assessment is made as to whether there is objective evidence that a financial asset or group of financial assets, not held at FVTPL, is impaired. Impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition and before the balance sheet date (a 'loss event') which has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower, a breach of contract, such as default or delinquency in interest or principal payments, the granting to the borrower, for economic and legal reasons relating to the borrower's financial difficulty, a concession that would not otherwise be considered, indications that a borrower or issuer will enter bankruptcy or other financial reorganisation, or the disappearance of an active market for a security.

Evidence for impairment for loans and advances is considered at both a specific asset and collective level.

ii. Forbearance
A policy of forbearance is operated which mitigates against borrower default. All such cases are included within provisioning methodology.

Residential secured mortgages
Loans under forbearance are categorised as impaired and collectively assessed for impairment.

Unsecured Retail business
Irrespective of forbearance, impairment is charged in accordance with the identified past due and unidentified loss event approaches described in the risk management section.

Corporate business
Accounts subject to forbearance which are in default are individually assessed for impairment. Loans under forbearance and on the watchlist are categorised as impaired and collectively assessed for impairment.

For further information on the approach to forbearance, its management and execution, see the risk management section.

b) Scope
i. Individual accounts
All secured loans and advances are assessed for impairment using a range of criteria graded for levels of risk. Accounts at risk of impairment are monitored and impaired where they display clear indicators of underperformance.

All Corporate loans in default, are individually assessed for impairment.

Loans and advances that do not meet the criteria for individual impairment, or which do, but are not found to be impaired, are collectively assessed for impairment (incurred but not yet reported) by grouping together loans and advances with similar risk characteristics.

ii. Collective accounts
a) Retail
When assessing collective impairment for secured Retail loans, a shortfall is estimated based on the difference between the current loan balance and the expected 'forced sale' price of collateral, discounted at the effective interest rate of the loan to reflect the anticipated time to sale, and taking into account anticipated fees and costs prior to sale. The shortfall is multiplied by the probability the loan will default and further multiplied by the probability that the loan will be taken into possession to determine the impairment required.

When assessing collective impairment for unsecured Retail loans, losses on loans are estimated via a two stage approach, which determines probability of default (PD) and loss given default (LGD) to generate provision rates which are applied to the current balance sheet, including loans transferred to debt collection agencies. Once impaired, accounts are subjected to higher levels of impairment according to both their relevant stage of delinquency, i.e. the number of days in arrears, and their consequent likelihood of ultimately being charged off. Default rates, loss rates and future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment provisions are determined by models and augmented where it feels direct model outputs do not adequately reflect all risks within a portfolio. Post model adjustments (PMAs) can be determined where:
- there is inaccurate or missing data;
- there is evidence of a loss event but comprehensive data does not exist; and/or
- one time events, such as changes to processes or Control Standards, which have yet to be reflected in modelled outputs.

Impairment determined both via provision models and post model adjustments are monitored and reviewed by the Senior Management team on an ongoing basis.

b) Corporate
Collective provisions are held for all Corporate exposures, apart from customers in default for which specific provisions have been raised. Collective provisions are determined by multiplying the drawn balance of the loan by the following default estimates:

i) the probability that, during the emergence period, balances will move to default; or
ii) the probability that, during the emergence period, balances will move to impaired; and
iii) the probability that, during the outcome period, balances will move from impaired to default.

The resulting balance is multiplied by the proportion of newly defaulted balances that ultimately move to an unrecoverable LGD.

The loss emergence period is defined as the time between a loss event occurring and it being evidenced. For Corporate loans the emergence period is six months and is reviewed annually. For all commercial real estate loans where the indexed loan-to-value (LTV) is greater than 100% and those loans which are due to contractually expire in the next 36 months and the indexed LTV is greater than 65%, the probability of emerging to impaired (Pe(i)) parameter is set to 100%. All other PD components are based on recently observed loan migration experience. Loans which are on watchlist are impaired and therefore (Pe(i)) is set to 100%.

c) Measurement
The amount of the loss is the difference between:

- the asset's carrying amount; and
- the present value of estimated future cash flows (discounted at the asset's original EIR for amortised cost assets and at the current market rate for available for sale assets).

Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of cost to realise, whether or not foreclosure or realisation of the collateral is probable.

d) Impairment of financial assets carried at amortised cost
The amount of the impairment loss on assets carried at amortised cost is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of an allowance account.

A write off is made when all or part of a claim is deemed uncollectable or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement.

Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

Provisions are released at the point at which it is deemed that, following a subsequent event, the risk of loss has reduced to the extent that a provision is no longer required.

e) Impairment of financial assets classified as available for sale
Available for sale assets are assessed at each balance sheet date to see whether there is objective evidence of impairment. In such cases, any impairment losses are recognised by transferring the cumulative loss that has been recognised directly in equity to profit or loss.

When a subsequent event causes the amount of impaired loss on available for sale investment securities to decrease, and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement. However, any further recovery in the fair value of an impaired available for sale equity security is recognised directly in equity.

1.3.5 Sale and repurchase agreements
Securities sold subject to repurchase agreements (repos) are reclassified on the balance sheet as pledged assets when the transferee has the right by contract or custom to sell or repledge the assets. The liability to the transferee is also included on the balance sheet, in deposits by banks. The difference between sale and repurchase price is accrued over the life of the agreements.

Securities purchased under agreements to re-sell reverse repos are classified as loans and advances to banks on the balance sheet, as appropriate.

1.3.6 Derivative financial instruments and hedge accounting
a) Derivatives used for asset and liability management purposes
Derivatives are used to hedge interest and exchange rate exposures related to non-trading positions. Instruments used for hedging purposes include swaps, forward rate agreements, options and combinations of these instruments.

Derivative financial instruments are stated at fair value using valuation techniques such as discounted cash flow models. Further information is provided in note 16 to the consolidated financial statements. All derivatives are carried as assets when the fair value is positive and liabilities when the fair value is negative. The gain or loss on re-measurement to fair value is recognised immediately in the income statement except where derivatives qualify for cash flow hedge accounting.

Where hedge accounting is applied, the economic relationship between the hedging instrument(s) and hedged item(s) is documented including the risk management objective and strategy in undertaking the hedge transaction together with the method used to assess effectiveness of the hedging relationship.

Also documented is the assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instruments are expected to be ‘highly effective’ in offsetting the changes in fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual offset in changes in fair value in each hedge are within a range of 80% to 125%.

i. Cash flow hedges
Where derivatives are designated as hedges of the exposure to variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the portion of the fair value gain or loss on the derivative that is determined to be an effective hedge is recognised directly in equity. The ineffective part of any gain or loss is recognised in the income statement immediately.

The accumulated gains and losses recognised in equity are reclassified to the income statement in the periods in which the hedged item will affect profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised at that time remains in equity until the forecast transaction is eventually recognised in the income statement.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately reclassified to the income statement.

ii. Fair value hedges
Where a derivative is designated as the hedging instrument to hedge the change in fair value of a recognised asset or liability or a firm commitment that could affect profit or loss, changes in the value of the derivative are recognised immediately in the income statement together with changes in the fair value of the hedged item that are attributable to the hedged risk.

Fair values are based on quoted market prices in active markets or, where these are not available, using valuation techniques such as discounted cash flow models. If the derivative expires or is sold, terminated, or exercised, or no longer meets the criteria for fair value hedge accounting, or the designation is revoked, then hedge accounting is prospectively discontinued. Any adjustment up to that point, to a hedged item for which the EIR method is used, is amortised to profit or loss as part of the recalculated EIR of the item over its remaining life.

iii. Fair value hedge accounting for a portfolio hedge of interest rate risk
As part of the risk management process, portfolios are identified where interest rate risk is to be hedged. The portfolios may comprise only assets, only liabilities or both assets and liabilities. Each portfolio is analysed into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur. Using this analysis, the percentage to hedge is decided and designated as the hedged item is an amount of assets or liabilities from each portfolio equal to this. The change in fair value of the portfolio relating to the risk that is being hedged is measured monthly. Provided that the hedge has been highly effective, the change in fair value for the hedged risk of each hedged item is recognised in the income statement with the cumulative movement in its value being shown on the balance sheet as a separate item, fair value adjustment for hedged risk, either within assets or liabilities as appropriate. If the hedge no longer meets the criteria for hedge accounting, this amount is amortised to the income statement over the remaining useful life of the hedge item on an appropriate basis.

The fair value of each hedging instrument is measured and this is included in derivative financial instruments in either assets or liabilities as appropriate, with the change in value recorded in the income statement.

Any hedge ineffectiveness is recognised in the income statement as the difference between the change in fair value of the hedged item for the hedged risk and the change in fair value of the hedging instrument.

b) Embedded derivatives
A derivative may be embedded in another instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract (and the host contract is not carried at fair value through profit or loss), the embedded derivative is separated from the host and held on-balance sheet at fair value. Movements in fair value are recognised in the income statement, whilst the host contract is accounted for according to the relevant accounting policy for that particular asset or liability.

1.3.7 Property, plant and equipment
Assets are recognised where there is substantial exposure to all the risks and rewards of those assets.

Items of property, plant and equipment are stated at cost less any accumulated depreciation and impairment losses. Depreciation is recognised on a straight line basis at the following maximum default rates, which are estimated to reduce the assets to their realisable values at the end of their useful lives.

Long leasehold land and buildings	40 years
Freehold and leasehold improvements	10 years
Short leasehold buildings	life of lease
Equipment:	
Computer	5 years
Furniture and equipment	10 years

All items of property, plant and equipment are reviewed for indications of impairment on a regular basis and at each balance sheet date. If impairment is indicated, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use) is estimated. Value in use is calculated by discounting the future cash flows generated from the continuing use of the asset. If the carrying value of the asset is greater than the recoverable amount, the shortfall is recognised in the income statement.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal, less costs to sell, with the carrying amount and are recognised net within operating expenses in the income statement.

1.3.8 Intangible assets
Intangible assets are recognised where there is substantial exposure to all the risks and rewards of those assets, and the assets are either separable or arising from contractual or legal rights.

a) Computer software
Computer software is stated at cost less cumulative amortisation and impairment, and comprises acquired computer software together with the costs of internal development of the software.

Acquired computer software licences are capitalised on the basis of cost incurred to acquire and bring the software to use.

Costs that are directly associated with the internal production of software products that will generate future economic benefit are capitalised. Only costs which meet the definition of development costs under IAS 38 (Intangible Assets) are capitalised. Costs are capitalised only if the asset can be reliably measured, will generate future economic benefits, the completion of the asset is feasible, there is an intention to complete the asset, an intention and ability to use the asset, and costs attributable to the asset are able to be reliably measured. Expenditure that is not directly attributable to the development of such assets is recognised in the income statement in the period to which it relates.

The expenditure capitalised includes direct employee costs and an appropriate portion of relevant direct overheads. Once the asset is available for use, amortisation is charged to the income statement on a straight line basis to allocate the cost over the estimated useful life up to a maximum of nine years.

b) Other intangible assets
Other intangible assets are stated at cost less cumulative amortisation and impairment. Amortisation is charged on a straight line basis over the useful life of the asset. A review of the asset's useful life is carried out and a maximum useful life of up to 10 years is applied.

c) Impairment
Intangible assets are assessed for indications of impairment at least annually. If impairment indicators are discovered, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use) is estimated. Value in use is calculated by discounting the future cash flows generated from the continuing use of the asset. If the carrying value of the asset is more than the greater of the value in use and the fair value less costs to sell, the difference is recognised as a charge to the income statement. Irrespective of whether there is any indication of impairment, intangible assets in the course of construction are tested for impairment at least annually.

1.3.9 Leases
a) Overview
Leases entered into relate to land and buildings, finance leases for software and operating leases for vehicles and equipment.

Leases for land and buildings are split between leases for the land and leases for the buildings for accounting purposes only. The leases are separately assessed as to whether they are finance or operating leases. The policy is to provide for the minimum future lease payments on buildings that are not currently used, net of expected rental income from sub-leases. Provisions are made for dilapidation where an obligation exists to make good dilapidation or other damage, or return the asset to the configuration that existed at the inception of the lease.

b) Assets leased to customers
All leases of assets to customers are finance leases. Income from assets leased to customers is credited to the income statement based on a pattern reflecting a constant periodic rate of return on the net investment in the lease.

c) Assets leased from third parties
i. Finance leases
The amount to be recognised as a finance lease is calculated on inception of the lease. Finance lease assets are capitalised at commencement of the lease (being the date at which the right to use the asset is exercised) at the lower of fair value of the leased asset and the present value of the minimum future lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. The interest element of the finance charge is allocated to the lease payments so as to record a constant periodic rate of charge on the outstanding liability.

ii. Operating leases
Operating lease payments are charged to the income statement on a straight line basis over the term of the lease and the asset is not recognised on the balance sheet.

1.3.10 Investment property
Property held for long term rental yields that is not owner occupied or property held for capital appreciation, is classified as investment property. Investment property comprises freehold land and buildings. All investment properties are accounted for using the fair value method. Fair value is based on current prices in an active market for similar properties in the same location and condition. No depreciation is provided on investment properties. Any gain or loss arising from a change in fair value is recognised in the income statement.

If an investment property becomes owner occupied, it is reclassified as property, plant and equipment and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes. Prior to such a transfer the property is measured at fair value with any gain or loss recognised in the income statement. Similarly, transfers to the investment property portfolio are made when owner occupancy ceases and the property meets the criteria of an investment property under IAS 40.

1.3.11 Cash and cash equivalents
Cash and cash equivalents comprises cash balances and balances with a maturity of three months or less from the acquisition date, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

1.3.12 Income tax

a) Overview

Tax for the year comprises current and deferred tax, which is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in the statement of comprehensive income. In addition, estimated impacts of changes in the timing of amounts receivable from Co-operative Group for tax losses surrendered are recorded as an adjustment to the tax expense. This receivable is referred to as the surrendered loss debtor.

b) Current tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

c) Deferred tax

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided for is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised and is supported by the Plan.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

1.3.13 Pension costs

a) Co-operative Pension Scheme

Participation continues in the Co-operative Pension Scheme (Pace). Pace is a hybrid scheme, consisting of a closed defined benefit section and a defined contribution section. There is currently insufficient information available to consistently and reliably identify the Group's share of its liabilities in respect of this multi-employer scheme. For this reason the pension costs in respect of Pace are accounted for on a defined contribution basis in accordance with IAS 19 Employee Benefits. Pension costs are recognised as an expense in the income statement. See note 29 to the consolidated financial statements for further details.

b) Britannia Pension Scheme

The Britannia scheme is a defined benefit scheme. The pension scheme surplus or deficit recognised in the balance sheet represents the difference between the fair value of the plan assets and the present value of the defined benefit obligation at the balance sheet date. The calculation of the defined benefit obligations is performed annually by qualified actuaries using the projected unit credit method and assumptions agreed with management.

The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of high quality corporate bonds that have terms to maturity approximating to the terms of the related pension liability. Plan assets are recorded at fair value. When the calculation results in a potential asset, the recognised asset reflects the present value of the economic benefits that will arise from the surplus in the form of any future refunds from the plan or reductions in future contributions to the plan, in accordance with IFRIC 14.

Actuarial remeasurements arise from experience adjustments (the effects of differences between previous actuarial assumptions and what has actually occurred) and changes in forward-looking actuarial assumptions. Actuarial remeasurements are recognised in full, in the year they occur, in other comprehensive income. Any changes in the present value of the defined benefit obligation resulting from plan amendments or curtailments are recognised immediately in profit or loss as past service costs. Obligations for contributions to defined contribution plans are expensed as the related service is provided.

1.3.14 Foreign currency

The functional and presentational currency is Pounds Sterling. Transactions in foreign currencies are translated at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Sterling at the foreign exchange rate prevailing at that date. Foreign currency differences arising on translation are recognised in the income statement, except for foreign currency differences arising on translation of available for sale equity instruments or a qualifying cash flow hedge, which are recognised directly in the statement of comprehensive income. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Sterling at the exchange rates prevailing at the dates the values were determined.

1.3.15 Investments in subsidiaries and Group undertakings

Investments in subsidiaries are initially measured at fair value which equates to cost and subsequently valued at cost less impairment.

1.3.16 Provisions for liabilities and charges

A provision is recognised in the balance sheet if there is a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at an appropriate pre-tax rate, if the expected future cash flows can be reliably estimated.

In the case of restructuring provisions, a constructive obligation arises when a plan is sufficiently detailed and is formalised and when the plan is deemed to have been communicated to relevant stakeholders impacted by the restructure. Restructuring provisions include only direct expenditure arising from the restructuring plan which is both necessary for restructuring and not associated with ongoing activities.

1.3.17 Share premium

Share premium is the amount by which the fair value of the consideration received exceeds the nominal value of shares issued. Expenses and commissions paid on the issue of shares are written off against the share premium of the same issue.

1.3.18 Assets held for sale

Non-current assets and disposal groups (including both the assets and liabilities of the disposal groups) are classified as held for sale when their carrying amounts will be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable.

Non-current assets held for sale and disposal groups are measured at the lower of their carrying amount and fair value less cost to sell, except for those assets and liabilities that are not within the scope of the measurement requirements of IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations) such as deferred taxes, financial instruments, investment properties, insurance contracts and assets and liabilities arising from employee benefits. These are measured in accordance with the accounting policies described above. Immediately before the initial classification as held for sale, the carrying amounts of the asset (or assets and liabilities in the disposal group) are measured in accordance with applicable IFRSs. On subsequent re-measurement of a disposal group, the carrying amounts of the assets and liabilities noted above that are not within the scope of the measurement requirements of IFRS 5 are re-measured in accordance with applicable IFRSs before the fair value less costs to sell of the disposal group is determined.

2. Critical judgements and estimates

The preparation of financial information requires management to make judgements and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. The critical judgements and estimates are the same for both the Group and Bank.

The judgements and assumptions that are considered to be the most important to the portrayal of the financial condition for the year ended 31 December 2017 are those relating to the Restructuring and Recapitalisation, loan impairment provisions, conduct risk provisions, pensions, separation provision, effective interest rates (EIR) and surrendered loss debtor.

Assumptions and estimates are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

2.1 Restructuring and Recapitalisation

	Group				
	Profit and loss	**Share capital**	**Share premium**	**Capital re-organisation reserve**	**Total**
Issuance of shares in exchange for existing debt and contributions	**397.8**	**0.9**	**313.8**	-	**712.5**
Costs associated with Restructuring and Recapitalisation transaction	**(41.5)**	**-**	**-**	**(21.8)**	**(63.3)**
Total effect of transactions on profit and reserves	**356.3**	**0.9**	**313.8**	**(21.8)**	**649.2**
Reclassification of Bank share capital and share premium	**-**	**(22.6)**	**(1,736.9)**	**1,759.5**	**-**

The Restructuring and Recapitalisation completed on 1 September 2017 resulted in an increase in the total equity of £649.2m. This amount is stated after deduction of costs and expenses of £63.3m.

The Restructuring and Recapitalisation included the following steps:

- the creation of the Holding Company: the transfer of all the Bank's ordinary shares to the Holding Company in exchange for A shares in the Holding Company implemented by way of the Members' Scheme. As a result of the Restructuring and Recapitalisation the Holding Company now owns 100% of the Bank;

- the exchange of all Subordinated Notes held by Subordinated Noteholders (other than the 2023 Notes held by Retail Noteholders) for A shares in the Holding Company and the Mandatory Cancellation of the 2023 Notes held by Retail Noteholders in consideration of the payment by the Bank of the Retail Cash Consideration to Retail Noteholders; and

- the subscription of an aggregate £250m of A shares in the Holding Company, the proceeds of which, together with the release of the Subordinated Notes, were used by the Holding Company to subscribe for shares in the Bank.

In aggregate this resulted in the cancellation of subordinated debt of the Bank with a carrying value of £468.7m in return for shares issued to the Holding Company by Bank and £6.3m of cash paid to Retail Noteholders.

The overall net gain on the Restructuring and Recapitalisation has been recorded partly through the income statement and partly through equity, in accordance with IFRS and the Companies Act.

The capital reorganisation reserve was recognised on the issuance of Holding Company shares in exchange for the acquisition of the entire share capital of The Co-operative Bank plc. The reserve reflects the difference between the consideration for the issuance of Holding Company shares and the Bank's share capital and share premium.

The key judgement that has been applied by management as part of the Restructuring and Recapitalisation was determining the fair value of the Bank at the time of the transaction. The implied fair value of the Bank was calculated on the basis that approximately 67.6% of the Holding Company represents the £250m of equity capital raise. Scaling this up to 100%, this would then equate to the fair value of the Holding Company and by virtue of the Holding Company having no trading operations of its own, the fair value of the Bank would therefore be equivalent to 100% of the Holding Company.

Bank
The impact of the Retail debt extinguishment and transaction costs on net assets is consistent between Group and Bank and has been recorded partly through the income statement and partly through equity as described above, in accordance with IFRS and the Companies Act. The difference between the fair value of the shares issued and the carrying amount of the bonds extinguished has been recognised directly in equity (via share premium as discussed in note 33 to the consolidated financial statements), as the loss is borne by the debt holder who is also the shareholder (i.e. the Holding Company) and constitutes a capital contribution.

2.2 Loan impairment provisions

2.2.1 Overview
The loan portfolios are reviewed on a regular basis to assess for impairment. In determining whether an impairment provision should be recorded, judgements are made as to whether there is objective evidence that a financial asset or portfolio of financial assets is impaired as a result of loss events that occurred after recognition of the asset and by the balance sheet date.

The calculation of impairment loss includes expectations of levels of future cash flow and is based on both the likelihood of a loan or advance being written off and the estimated loss on such a write off.

The changes in impairment provisions for all books of business result from management review of assumptions with respect to the determination and operational alignment of: the probability of the possession of collateral given default (PPD); treatment of forbearance; length of loss emergence periods; timing of impairment recognition, and the formalising of charge off policy. Further explanation of the treatment of forborne balances is included in the risk management disclosures.

Additional impairment may be raised via a post model adjustment (PMA) where it is felt that the collective impairment determined via the approved impairment model does not adequately capture the perceived risks inherent within a particular portfolio.

2.2.2 Collective provisions
Loans which have not been assessed individually for impairment are assessed for collective impairment. Collective provisions cover losses which have been incurred but not yet identified on loans subject to individual assessment and for homogeneous groups of loans that are not considered individually significant. Typically, retail lending portfolios are assessed for impairment on a collective basis as the portfolios generally consist of large pools of homogenous loans.

i) Retail
The collective provision for unsecured and secured retail personal advances is £41.1m (31 December 2016: £61.3m). The provision has reduced in the period due to debt sale initiatives relating to non performing Credit Card and Current Account balances, offset by increases in secured provisions relating to growth in the Platform portfolio and provision coverage associated with Interest Only mortgages.

A key estimate within the unsecured models is the probability that impaired accounts move to a default status during the outcome period. The model uses historical actual data over a defined period of time to arrive at an average probability of accounts moving to default. If the maximum observed probability of default (PD) from the last six months had been used for each category of arrears and for each product, this would increase the collective provision by £3.0m for all of the unsecured portfolios.

A key estimate of the secured impairment model is forced sales discount. The forced sales discount is an average and is calculated using historical actual data over a defined outcome period. If the maximum forced sales discount for the outcome period was used to calculate the provision across the secured portfolios excluding Optimum it would increase by £0.4m.

A key estimate is the collateral value. A 10% decrease to the indexed collateral used in the model would increase the provision across the secured portfolios, excluding Optimum, by £0.8m.

ii) BaCB
The collective provision against corporate loans has decreased to £0.3m (31 December 2016: £0.5m). A key estimate is default rates. The impact of increasing the default rates by 10% results in a 13.4% increase in collective provision (<£0.1m). The impact of increasing other parameters that affect the loss rate by 10% is insignificant.

iii) Legacy Portfolio

The collective provision against Legacy portfolio loans has increased to £1.6m (31 December 2016: £1.3m) driven by provision increase, based on expert judgement, in relation to a single counterparty. A key estimate is default rates. The impact of increasing the default rates by 10% results in a 6.8% increase in collective provision (+£0.1m). The impact of increasing other parameters that affect the loss rate by 10% is insignificant.

iv) Optimum

In addition to the above, collective provisions of £8.0m (31 December 2016: £12.5m) are held in the Optimum segment. The provision has reduced in the period due to Warwick Finance Three securitisation.

A key estimate of the secured impairment model provisioning is forced sale discount. The forced sale discount is an average and is calculated using historical actual data over a defined outcome period. If the maximum forced sales discount for the outcome period was used to calculate the provision it would increase by £0.5m.

A key estimate is the collateral value. A 10% decrease to the indexed collateral values used in the model would increase the provision by £2.6m.

2.3 Conduct risk provisions

2.3.1 Overview

The conduct and legal risks provision involves significant judgement and therefore constitutes one of the critical accounting estimates.

Significant components of the conduct risk and legal provision are potential customer redress in relation to Payment Protection Insurance (PPI) and Mortgage issues relating to incorrect monthly customer payments. Provisions for conduct issues requiring redress which are individually less significant have also been made.

The calculation of these conduct and legal provisions requires significant judgement by management in determining appropriate assumptions. Key assumptions include basis of redress, operating costs of resolving redress, legal analysis, the level of complaints, internal uphold rates, proactive contact and response rates and the FOS referral and uphold rates.

2.3.2 Payment Protection Insurance (PPI)

A provision of £88.9m (31 December 2016: £90.4m) has been recorded in respect of potential customer redress relating to past sales of PPI. The provision is in respect of the total expected cost of carrying out this work and paying compensation, making total provisions raised to date of £498.3m (31 December 2016: £459.8m).

The PPI charge is £38.5m in 2017 split across both redress and delivery. This increase has been recognised following the FCA published paper PS17/03 which requires firms to respond to all previously rejected Plevin complaints, increased delivery costs due to increased inbound volumes, increased proportion of valid claims and building operational resilience following FCA marketing campaigns.

The PPI provision is based on the FCA time bar coming into force on 29 August 2019 in line with the FCA announcement on 2 March 2017.
Other key assumptions within the calculation of the current provision are complaint volumes, uphold rates, administration costs and average redress.

The current position, expected movement in position and baseline sensitivities of the key estimates are outlined below:

Description of estimate	Current position	Future expected	Sensitivity on current position
Number of inbound valid[1] complaints	115k	25k	1,000 = £2.2m
Proactive Mailings	56k	0k	1,000 = £1.7m
Response rate to proactive mailings	60%	45%	1% = £1.2m
Average uphold rate per valid[1] complaint	59%	71%	1% = £0.6m
Average redress per upheld complaint[2]	£3,355	£2,508	£100 = £1.8m

1. Valid complaints excludes those complaints for which no PPI policy exists
2. Average redress per upheld complaint included all complaints either inbound or in response to proactive mailings that were offered redress

2.4 Defined contribution accounting for the Pace scheme

Pace is a hybrid pension scheme consisting of a closed defined benefit section and a defined contribution section. There is currently insufficient information available to consistently and reliably identify the Group's share of its liabilities in respect of this multi-employer scheme. For this reason defined benefit accounting is not possible and pension costs in respect of Pace are accounted for on a defined contribution basis in accordance with IAS 19 Employee Benefits (revised 2011). Pension costs are recognised as an expense in the income statement.

2.5 Separation provision
A provision of £nil (31 December 2016: £27.3m) is held against separation costs directly relating to the obligation to separate from Co-operative Group.

The provision held at 31 December 2016 was partially utilised during 2017 with the remainder released as it was judged that both the legal obligations to customers and constructive obligations to restructure IT operations from Co-operative Group were satisfied. This matter has been considered against the principles applied when recognising the original separation provision and it has been judged that there is no further obligation in relation to separation from Co-operative Group, and therefore no provision has been recognised for 2017 year end. Further separation costs will be taken as expenditure and capitalised as relevant in accordance with the appropriate standards.

2.6 Effective Interest Rate (EIR)
When calculating the EIR to apply to an asset or liability held at amortised cost, future cash flows are estimated considering all contractual terms of an instrument. In most cases, the future cash flows arising from an asset or liability will be dependent on a number of variables, such as the proportion of mortgage customers who do not switch product after a discount period ends, future interest rates or the Standard Variable Rate. Therefore, it follows that management is required to apply significant judgement in creating assumptions about the value of these variables in the future.

In calculating the EIR adjustment to apply to mortgage balances, the most significant two assumptions in terms of impact and volatility are:
- Standard Variable Rate (SVR); and
- Timing of redemptions (behavioural lives).

- **Standard Variable Rate**
  The assumed standard variable rate which will be in effect at the end of a fixed rate product term determines expected income to be received post-reversion. This is determined with reference to expected Bank of England base rate rises, with a proportion of future increases assumed to pass through to the Bank's Standard Variable Rate.

  As a measure of the sensitivity of these models, a 0.5% increase in the assumed standard variable rate in place after the expiry of the fixed rate period for all products would result in a £5.4m (13.4%) increase in the EIR adjustment required to the loans and advances to customers balance as at 31 December 2017.

- **Timing of redemptions (behavioural lives):**
  Once a customer reaches the expiry of the fixed rate period on the fixed product, interest is charged at the standard variable rate (SVR), which is higher than the product fixed rate. The amount of time that the customer stays on SVR affects the total lifetime income from the customer, which affects the EIR adjustment.

  As a measure of the sensitivity of these models, if all repayments forecast to occur after the expiry of the fixed rate period for all products were to occur one month earlier it would result in a £2.9m (7.1%) decrease in the EIR adjustment required to the loans and advances to customers balance as at 31 December 2017.

2.7 Surrendered loss debtor
As part of the negotiations relating to the separation of the Bank from Co-operative Group, the Bank and Co-operative Group agreed terms relating to the surrender of group relief between the entities in the Bank's tax group and entities in Co-operative Group tax group. A deed sets out the basis of the agreement by Co-operative Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 31 December 2013. The deed also addresses the terms of the payment by Co-operative Group to the Bank for those tax losses. The 2017 consolidated financial statements, which include a surrendered loss debtor of £71.6m (31 December 2016: £84.1m), have been prepared on a basis consistent with the deed.

The Bank receives payment from Co-operative Group when Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised. The value of the asset is sensitive to a number of assumptions including the forecast repayments provided by Co-operative Group for the periods to 2020; Co-operative Group's capital expenditure qualifying for capital allowances in future periods; Co-operative Group's taxable profits in future periods; the Bank's extrapolation of the forecast repayments for the periods after 2020; changes in tax legislation, including the rate of corporation tax and the rates at which capital allowances on qualifying capital expenditure are available; and Co-operative Group's capacity to claim the tax losses. If future payments from Co-operative Group are deferred by one year from the current estimates, the value of the surrendered loss debtor reduces by £7.9m.

Increasing the corporation tax rate by 1% from 1 April 2021 increases the value of the surrendered loss debtor by £2.3m. If, for example, it is assumed that the corporation tax rate increases back to 20% from 1 April 2021 onwards, the value of the surrendered loss debtor increases by £7m.

3. Segmental information
The Bank was managed as two divisions during the prior year, Core and Non-core. As of 2017, operations are no longer managed as two separate divisions. Revenues are attributed to the segment in which they are generated.

The Board relies primarily on net interest income to assess the performance of each segment. As a result interest income is reported on a net basis to the Board.

The table below represents the management accounts, as presented in the Detailed Financial Review. See page 10 for the business areas.

	Group and Bank						
	Retail	**BaCB**	**Treasury**	**Legacy Portfolio**	**Optimum**	**Other**	**Total**
2017							
Net interest income/(expense)	**300.0**	**37.4**	**(7.3)**	**(3.4)**	**(10.7)**	**1.6**	**317.6**
Loss on asset sales	**-**	**-**	**-**	**(5.7)**	**(20.8)**	**-**	**(26.5)**
Non-interest income/(expense)	**19.1**	**17.6**	**18.8**	**0.1**	**(0.2)**	**(0.5)**	**54.9**
Operating income/(expense)	**319.1**	**55.0**	**11.5**	**(9.0)**	**(31.7)**	**1.1**	**346.0**
Impairment (losses)/gains on loans and advances	**(9.1)**	**0.2**	**-**	**4.4**	**5.6**	**-**	**1.1**
Contribution Result	**310.0**	**55.2**	**11.5**	**(4.6)**	**(26.1)**	**1.1**	**347.1**
Operating expenditure - staff							**(152.6)**
Operating expenditure - non-staff							**(236.5)**
Operational project expenditure							**(13.6)**
Operating result							**(55.6)**
Conduct risk							**(27.4)**
Remediation project expenditure							**(50.9)**
Strategic project expenditure							**(23.8)**
Severance							**(7.0)**
Other exceptional items							**431.0**
Share of post-tax profits from joint ventures							**0.4**
Fair value unwinds							**(50.7)**
Group profit before taxation							**216.0**
Income tax							**16.7**
Group profit after taxation							**232.7**
Group consolidation adjustment							**(390.4)**
Bank loss after taxation							**(157.7)**

	Group and Bank						
	Retail	BaCB	Treasury	Legacy Portfolio	Optimum	Other	Total
Re-presented 2016[1]							
Net interest income/(expense)	344.8	50.6	8.5	(1.1)	(16.8)	8.8	394.8
Loss on asset sales	-	-	-	(14.0)	-	-	(14.0)
Non-interest income	28.0	12.7	11.1	8.4	1.1	5.9	67.2
Operating income/(expense)	372.8	63.3	19.6	(6.7)	(15.7)	14.7	448.0
Impairment (losses)/gains on loans and advances	(0.5)	0.3	-	(1.2)	(1.0)	0.1	(2.3)
Contribution result	372.3	63.6	19.6	(7.9)	(16.7)	14.8	445.7
Operating expenditure - staff							(187.7)
Operating expenditure - non-staff							(257.1)
Operational project expenditure							(33.9)
Operating result							(33.0)
Conduct risk							(24.9)
Remediation project expenditure							(141.3)
Strategic project expenditure							(134.3)
Severance							(21.5)
Other exceptional items							58.1
Share of post-tax profits from joint ventures							0.3
Fair value unwinds							(180.5)
Loss before taxation							(477.1)
Income tax							58.4
Loss after taxation							(418.7)

1. The 2016 results have been re-presented, as described in the Detailed Financial Review.

The 2016 income statement includes a reclassification of a £0.5m gain on sale of residential mortgage backed securities (RMBS) assets from Treasury losses/gains on asset sales to Treasury non-interest income. This reclassification has been made as all other gains or losses recorded on the sales of Treasury assets are recorded within non-interest income.

The table below represents the reconciliation of the management accounts presentation in the Detailed Financial Review and the segmental note back to the income statement.

	Group and Bank	
		Re-presented
	2017	2016
Net interest income		
Total interest margin for reportable segments	**317.6**	394.8
Interest fair value unwind	**(53.5)**	(172.2)
Provision for customer redress claims	**(0.4)**	(2.3)
Net interest income	**263.7**	220.3
Non-interest income		
Total non-interest income for reportable segments	**54.9**	67.2
Loss on asset sales	**(26.5)**	(23.6)
Asset sales impairment release	**3.0**	-
Gains on share sales	**22.8**	58.1
Interest fair value unwind	**9.8**	-
Non-interest income	**64.0**	101.7
Comprising:		
Net fee and commission income	**26.8**	40.9
Income from investments	**0.2**	0.2
Other operating income	**37.0**	60.6
	64.0	101.7
Operating expenses		
Total operating expenditure	**(389.1)**	(444.8)
Project expenditure and severance	**(95.3)**	(331.0)
Restructuring and Recapitalisation expenses	**(41.5)**	-
Interest fair value unwind	**(7.0)**	(7.2)
Provision for legal charges	**-**	(0.2)
Operating expenses	**(532.9)**	(783.2)
Provision for customer redress		
Conduct risk	**(27.4)**	(24.9)
Provision for conduct risk included within interest income	**0.4**	2.3
Provision for legal charges included within operating expenses	**-**	0.2
Provision for customer redress	**(27.0)**	(22.4)
Interest fair value unwind		
Fair value unwind	**(50.7)**	(180.5)
Interest income unwind	**53.5**	172.2
Non-interest income	**(9.8)**	-
Impairment unwind	**-**	1.1
Operating expenses unwind	**7.0**	7.2
Interest fair value unwind	**-**	-
Impairment gains on loans and advances		
Total impairment gains/(losses) on loans and advances for reportable segments	**1.1**	(2.3)
Impairment unwind	**-**	(1.1)
Asset sales impairment release included within non-interest income	**(3.0)**	-
Losses on asset sales	**-**	9.6
Impairment gains/(losses) on loans and advances	**(1.9)**	6.2

	Group and Bank	
	2017	Re-presented 2016
Gain on capital raise		
Other exceptional items	**431.0**	58.1
Gains on sale of equity shares included within non-interest income	**(22.8)**	(58.1)
Gain on pension scheme modification	**(51.9)**	-
Restructuring and Recapitalisation included within operating expenses	**41.5**	-
Group gain on capital raise	**397.8**	-
Less Group consolidation adjustment	**(390.4)**	-
Bank gain on capital raise	**7.4**	-

The 31 December 2016 balance sheet includes a number of reallocations across business segments following progress made in the transformation of finance processes. This has resulted in a reallocation of £0.1bn of previously unallocated assets and £0.2bn of Optimum assets to the Other business unit. Furthermore, £0.6bn of previously unallocated liabilities have been reallocated into the Other business unit. These reallocations reflect the way the business was managed during 2017. Following a review of our documentation, obligatory netting arrangements were found to be in place for repos and reverse repos transactions. As a result the prior year Treasury assets and liabilities have been re-presented and reduced by £0.2bn.

The table below represents segmental analysis of assets and liabilities on a management accounts basis as presented in the Detailed Financial Review.

	Group and Bank						
2017	**Retail**	**BaCB**	**Treasury**	**Legacy Portfolio**	**Optimum**	**Other**	**Total**
Segment assets	**14,705.8**	**308.5**	**7,258.3**	**1,099.4**	**585.7**	**532.4**	**24,490.1**

	Group						
2017	**Retail**	**BaCB**	**Treasury**	**Legacy Portfolio**	**Optimum**	**Other**	**Total**
Segment liabilities	**18,388.5**	**2,125.1**	**2,088.1**	**99.0**	**-**	**283.8**	**22,984.5**

	Bank						
2017	**Retail**	**BaCB**	**Treasury**	**Legacy Portfolio**	**Optimum**	**Other**	**Total**
Segment liabilities	**18,388.5**	**2,125.1**	**2,088.1**	**99.0**	**-**	**283.9**	**22,984.6**

	Group and Bank						
2016 Re-presented[1]	Retail	BaCB	Treasury	Legacy Portfolio	Optimum	Other	Total
Segment assets	14,844.6	434.9	7,615.5	1,471.4	2,605.8	437.5	27,409.7

2016 Re-presented[1]	Retail	BaCB	Treasury	Legacy Portfolio	Optimum	Other	Total
Segment liabilities	19,405.1	2,719.3	3,562.5	61.3	-	703.0	26,451.2

1. The comparative figures have been re-presented to more fairly reflect their nature. Further information can be found in note 13 and note 22 of the consolidated financial statements and the Detailed Financial Review.

4. Auditors' remuneration

	Group and Bank	
	2017	2016
	£'000	£'000
Fees payable to the Bank's auditor for the audit of the annual accounts	**2,985**	3,115
Audit expenses	**200**	250
Fees payable to the Bank's auditor for other services:		
Audit of the accounts of subsidiaries	**110**	125
Audit-related assurance services	**160**	160
Other assurance services	**45**	40
Total audit fees and expenses for the financial year	**3,500**	3,690
All other services provided by the auditor	**2,000**	40
Total auditor remuneration	**5,500**	3,730

Bank Company has borne the cost of the audit fees for the consolidated Group.

5. Directors' emoluments

	Group and Bank	
	2017	2016
	£'000	£'000
Amounts receivable	**5,288**	5,205
Sums paid to third parties in respect of Directors' services	**-**	19
Total Directors' emoluments	**5,288**	5,224

No retirement benefits are accruing to Directors under defined benefit schemes.

The aggregate of emoluments and amounts receivable under incentive schemes of the highest paid Director was £2.3m (2016: £2.1m).

6. Net interest income

		Group and Bank	
	Note	**2017**	2016
Interest receivable and similar income			
On financial assets not at fair value through profit or loss:			
On loans and advances to customers		**520.8**	664.1
On loans and advances to banks		**7.9**	21.5
On investment securities		**52.3**	72.3
Net interest income on net defined benefit pension asset	29	**0.6**	1.6
Total of financial assets not at fair value through profit or loss		**581.6**	759.5
On financial assets at fair value through profit or loss:			
Net interest expense on financial instruments hedging assets		**(31.9)**	(28.2)
Net interest income on financial instruments not in a hedging relationship		**5.2**	6.5
Total interest receivable and similar income		**554.9**	737.8

		Group and Bank	
	Note	**2017**	2016
Interest expense and similar charges			
On financial liabilities not at fair value through profit or loss:			
On customer accounts		**(128.4)**	(204.8)
On subordinated liabilities, debt securities in issue and other deposits		**(155.5)**	(316.5)
Net interest expense on net defined benefit pension liability	29	**(0.2)**	(0.6)
Total of financial liabilities not at fair value through profit or loss		**(284.1)**	(521.9)
On financial liabilities at fair value through profit or loss:			
Net interest (expense)/income on financial instruments hedging liabilities		**(3.8)**	8.5
Net interest expense on financial instruments not in a hedging relationship		**(3.3)**	(4.1)
Total interest expense and similar charges		**(291.2)**	(517.5)

Interest expense on subordinated liabilities and debt securities in issue includes fair value unwind on debt securities in issue of £58.3m (2016: £176.8m), further details of which are provided in note 34 to the consolidated financial statements.

7. Net fee and commission income/(expense)

The net fee and commission income for the Group and Bank, relate to items not at fair value through profit or loss.

8. Other operating income/(expense)

	Group and Bank	
	2017	2016
Profit on sale of investment securities	**6.3**	18.4
Gain on sale of equity shares[1]	**22.8**	58.1
Change in fair value of investment properties	**0.1**	0.2
Loss on sale of loans and advances to customers	**(11.5)**	(7.2)
Fair value movement on loans and advances to customers designated at fair value	**(6.5)**	7.4
Fair value movement on loans and advances to customers held for trading	**0.1**	(15.5)
Foreign exchange gains	**5.3**	8.2
Income / (expense) from derivatives and hedge accounting	**16.6**	(40.1)
Income from assets and liabilities held at fair value through profit or loss	**2.4**	23.0
Other	**1.4**	8.1
Total other operating income	**37.0**	60.6

1. This gain has arisen as a result of the sale of shares in VocaLink Holdings Limited (2016: Visa Europe).

Income/(expense) from derivatives and hedge accounting in the table above includes £7.2m of hedge ineffectiveness in 2017, being £5.4m from cash flow hedge programmes and £1.8m from fair value hedge programmes. In 2016 this was £(9.3m), £(2.5m) from cash flow and £(6.8m) from fair value programmes.

9. Operating expenses

		Group and Bank	
	Note	**2017**	Re-presented[1] 2016
Staff costs	10	**200.0**	299.3
Depreciation of property, plant and equipment	19	**4.2**	12.0
Amortisation of intangible fixed assets	18	**31.2**	29.1
Impairment of property, plant and equipment	19	**0.5**	0.5
Impairment of intangible assets	18	**3.1**	40.6
Loss/(profit) on sale of property, plant and equipment		**(0.1)**	(4.8)
Operating lease rentals		**15.0**	20.0
Provisions for liabilities and charges provided in the period	27	**16.6**	56.5
Financial Services Compensation Scheme Levies	27	**-**	4.9
Administrative expenses		**262.4**	325.1
Total operating expenses		**532.9**	783.2

1. The 2016 re-presentation relates to provisions for liabilities and charges, which now shows the operating expense impact of all provisions, rather than only property. This is based on materiality grounds, as property provision has a negligible contribution in the overall operating expense note (2017: £0.3m, 2016: £1.0m).

10. Staff costs

		Group and Bank	
	Note	**2017**	2016
Wages and salaries		**123.4**	146.0
Social security costs		**13.0**	15.2
Pension costs:			
Defined benefit plans	29	**5.0**	5.0
Defined contribution plans	29	**7.7**	12.1
Other staff costs		**50.9**	121.0
Total staff costs		**200.0**	299.3

Other staff costs primarily include costs paid to contractors and severance costs.

Average number of employees

The average headcount of persons working during the year is as follows:

	Group and Bank	
	No. of employees 2017	No. of employees 2016
Full Time	**3,072**	3,748
Part Time	**893**	1,018
	3,965	4,766

11. Income tax

	Group and Bank	
	2017	2016
Current tax		
Current year	**8.5**	(23.9)
Prior year	**(0.1)**	0.1
Total current tax	**8.4**	(23.8)
Deferred tax		
Current year	**(27.3)**	(41.4)
Prior year	**-**	5.5
Impact of corporation tax rate changes	**2.2**	1.3
Total deferred tax	**(25.1)**	(34.6)
Total tax credit	**(16.7)**	(58.4)

In addition to the above, included within other comprehensive income is a deferred tax charge of £6.9m (2016: £8.6m).

Further information on deferred tax is presented in note 28 to the consolidated financial statements. The tax on the profit/(loss) before taxation differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

	Group		Bank	
	2017	2016	**2017**	2016
Profit/(loss) before taxation	**216.0**	(477.1)	**(174.4)**	(477.1)
Tax calculated at a rate of 19.25% (2016: 20.0%)	**41.6**	(95.4)	**(33.5)**	(95.4)
Effects of:				
Non-taxable gain on Restructuring and Recapitalisation	**(75.1)**	-	**-**	-
Adjustment to surrendered loss debtor	**14.1**	(17.5)	**14.1**	(17.5)
Expenses not deductible for tax purposes	**12.7**	8.5	**12.7**	8.5
Unrecognised deferred tax	**(5.5)**	47.5	**(5.5)**	47.5
Discount of surrendered loss debtor	**(5.6)**	(6.4)	**(5.6)**	(6.4)
Impact of surcharge tax	**(2.4)**	(4.2)	**(2.4)**	(4.2)
Impact of corporation tax rate change	**2.2**	1.3	**2.2**	1.3
Other differences	**1.4**	2.2	**1.4**	2.2
Adjustments to tax charge in respect of prior periods	**(0.1)**	5.6	**(0.1)**	5.6
	(16.7)	(58.4)	**(16.7)**	(58.4)

Amounts receivable from Co-operative Group for tax losses surrendered and changes in that amount are recorded as an adjustment to the tax expense. The surrendered loss debtor adjustment has arisen primarily as a result of a revised repayment profile provided by Co-operative Group.

12. Cash and balances at central banks

	Group and Bank	
	2017	2016
Cash in hand	**49.1**	50.5
Items in transit	**(35.9)**	-
Balances with the Bank of England other than mandatory reserve deposits	**3,981.3**	2,756.7
Included in cash and cash equivalents	**3,994.5**	2,807.2
Mandatory reserve deposits with the Bank of England	**37.6**	41.0
	4,032.1	2,848.2

Mandatory reserve deposits are not available for use in the day-to-day operations, are non-interest bearing and are not included in cash and cash equivalents. Items in transit represent unpresented cheques, which were reclassified from deposits by banks and other liabilities in order to more fairly reflect their nature.

13. Loans and advances to banks

	Group and Bank	
		Re-presented[1]
	2017	2016
Items in course of collection from other banks	**12.8**	9.6
Placements with other banks	**462.1**	449.5
Included in cash and cash equivalents	**474.9**	459.1
Other loans and advances to banks	**99.9**	199.2
	574.8	658.3

1. Following a review of our documentation, obligatory netting arrangements were found to be in place for repos and reverse repos transactions. As a result the amount reduced by netting is £300.0m (2016 Re-presented: £178.6m), with the opposing impact in Deposits by banks in note 22 to the consolidated financial statements.

14. Loans and advances to customers

	Group and Bank	
	2017	2016
Gross loans and advances	**16,824.5**	19,575.0
Less: allowance for losses	**(80.0)**	(122.3)
	16,744.5	19,452.7

Loans and advances to customers include £175.0m (31 December 2016: £188.9m) of financial assets at fair value through profit or loss designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency, and £3.2m (31 December 2016: £4.1m) of financial assets held for trading. Of these, £80.2m (31 December 2016: £118.5m) are secured by real estate collateral.

Loans and advances to customers include £1.2bn (31 December 2016: £1.8bn) pledged under the securitisation and covered bond activities. There remains exposure to substantially all of the risks and rewards of ownership of these assets. Secured on these mortgage assets are £nil (31 December 2016: £nil) of deposits by banks and £0.6bn (31 December 2016: £1.1bn) of fixed and floating rate notes.

Concentration of exposure

Exposure is predominantly within the UK. Further information on the concentration of exposure is included within the risk management disclosures.

Allowance for losses on loans and advances

	Group and Bank								
	Retail		BaCB		Legacy Portfolio		Optimum		
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective	Total
2017									
At the beginning of the year	**-**	**61.3**	**0.5**	**0.5**	**46.2**	**1.3**	**-**	**12.5**	**122.3**
Reclassification between collective and individual	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Charge/(release) against profits	**-**	**10.6**	**-**	**(0.2)**	**(2.4)**	**0.3**	**-**	**(4.6)**	**3.7**
Amounts written off	**-**	**(30.8)**	**(0.1)**	**-**	**(15.1)**	**-**	**-**	**(3.2)**	**(49.2)**
Unwind of discount allowance	**-**	**-**	**-**	**-**	**(0.1)**	**-**	**-**	**-**	**(0.1)**
Merger fair value write off[1]	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**3.3**	**3.3**
At the end of the year	**-**	**41.1**	**0.4**	**0.3**	**28.6**	**1.6**	**-**	**8.0**	**80.0**

1. The remaining Britannia merger fair value has been written off in 2017. Refer to note 34 to the consolidated financial statements – Fair values of financial assets and liabilities for further information.

	Group and Bank
	2017
Charge against profits shown above	**3.7**
Transfer to loss on sale of assets - loans and receivables	**3.0**
Amounts recovered against amounts previously written off	**(4.9)**
Provision against fair value adjustment for hedged risk	**0.1**
Net impairment losses shown in income statement	**1.9**

	Group and Bank								
	Retail		BaCB		Legacy Portfolio		Optimum		
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective	Total
2016									
At the beginning of the year	2.8	101.5	1.0	0.8	118.4	7.5	9.9	3.3	245.2
Reclassification between collective and individual	(2.8)	2.8	-	-	-	-	(9.9)	9.9	-
Charge/(release) against profits	-	1.2	(0.1)	(0.3)	20.6	(6.2)	-	1.6	16.8
Amounts written off	-	(44.2)	(0.4)	-	(91.6)	-	-	(2.3)	(138.5)
Unwind of discount allowance	-	-	-	-	(1.2)	-	-	-	(1.2)
At the end of the year	-	61.3	0.5	0.5	46.2	1.3	-	12.5	122.3

	Group and Bank
	2016
Charge against profits shown above	16.8
Transfer to loss on sale of assets - loans and receivables	-
Amounts recovered against amounts previously written off	(19.0)
Provision against fair value adjustment for hedged risk	(4.0)
Net impairment gains shown in income statement	(6.2)

Loans and advances to customers include finance lease receivables:

	Group and Bank	
	2017	2016
Gross investment in finance leases may be analysed as follows:		
No later than one year	**5.2**	8.0
Later than one year and no later than five years	**13.2**	15.3
Later than five years	**11.6**	14.1
	30.0	37.4
Unearned future finance income on finance leases	**(7.7)**	(8.7)
Net investment in finance leases	**22.3**	28.7

The net future finance leases may be analysed as follows:

No later than one year	**3.8**	6.4
Later than one year and no later than five years	**10.0**	11.8
Later than five years	**8.5**	10.5
	22.3	28.7

There are no unguaranteed residual values for any of the finance leases.

Finance lease arrangements are with customers in a wide range of sectors including transport, retail and utilities.

15. Investment securities

a) Loans and receivables

	Group and Bank	
	2017	2016
Loans and receivables:		
Listed	**100.0**	13.8
Total gross investment securities - loans and receivables	**100.0**	13.8
Less: allowance for losses	**-**	-
Total net investment securities - loans and receivables	**100.0**	13.8

Movement in investment securities - loans and receivables

	Group and Bank	
	2017	2016
At the beginning of the year	**13.8**	15.0
Acquisitions	**86.8**	-
Disposals and maturities	**(0.9)**	(1.2)
Movement in interest accrual	**0.3**	-
At the end of the year	**100.0**	13.8

b) Available for sale

	Group and Bank	
	2017	2016
Available for sale:		
Listed	**2,287.7**	3,538.1
Total gross investment securities available for sale	**2,287.7**	3,538.1
Less: allowance for losses	**-**	-
Total net investment securities available for sale	**2,287.7**	3,538.1

Included in investment securities are repurchase receivables of £833.6m. These receivables are gilts subject to repurchase transactions where the transferee has the ability to re-pledge or sell the assets. £165.1m of Warwick Finance Two securitisation notes have been pledged, with a 17% haircut, as security against the increased shortfall in the actuarial funding shortfall estimated by the Britannia Pension Scheme actuary on 31 March 2016. See note 29 to the consolidated financial statements for further details.

Movement in investment securities - available for sale

	Group and Bank	
	2017	2016
At the beginning of the year	**3,538.1**	4,296.8
Acquisitions	**321.3**	363.7
Disposals and maturities	**(1,520.8)**	(1,161.5)
Fair value movements through equity	**(0.5)**	12.7
Fair value through profit or loss	**(48.5)**	32.2
Amortisation	**2.6**	(1.5)
Movement in interest accrual	**(6.2)**	(4.3)
Write back of previously written off assets	**1.7**	-
At the end of the year	**2,287.7**	3,538.1

c) Analysis of investment securities by issuer

	Group and Bank	
	2017	2016
Investment securities issued by public bodies:		
Government securities	**1,113.0**	1,661.5
Other public sector securities	**223.8**	173.7
Total investment securities issued by public bodies	**1,336.8**	1,835.2
Other debt securities:		
Other fixed and floating rate notes	**127.4**	395.5
Mortgage backed securities	**923.5**	1,321.2
Total investment securities issued by other issuers	**1,050.9**	1,716.7
Total investment securities	**2,387.7**	3,551.9

Other floating-rate notes (FRNs) relate to Sterling denominated FRNs with contractual maturities ranging from six months to seven years from the balance sheet date.

16. Derivative financial instruments

Various derivatives have been entered into as principal, either as economic hedges which are treated as held for trading (not in a qualifying hedge relationship), or in a qualifying hedge accounting relationship for the management of interest rate risk and foreign exchange rate risk. Positive and negative fair values have not been netted off as there is not a legal right of offset.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Group. Derivatives used to manage interest rate related positions include swaps, caps and floors and forward rate agreements. The foreign exchange rate positions are managed using forward currency transactions and swaps. Equity risk is managed using equity swaps.

During the year fair value hedges have been entered into to mitigate price movements due to interest rate sensitivities.

	Group and Bank			
	2017 Fair value		2016 Fair value	
	Assets	**Liabilities**	Assets	Liabilities
Derivatives held for non-trading purposes				
Derivatives designated as cash flow hedges:				
Interest rate swaps	**44.7**	**(4.9)**	72.1	(3.6)
Derivatives designated as fair value hedges:				
Interest rate swaps	**32.8**	**(136.9)**	64.4	(246.3)
Cross currency interest rate swaps	**-**	**-**	123.3	-
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**154.4**	**(172.8)**	162.4	(193.2)
Cross currency interest rate swaps	**-**	**-**	-	(0.5)
Forward currency transactions	**0.5**	**(0.4)**	0.4	(0.6)
OTC interest rate options	**-**	**-**	0.3	(0.3)
Equity swaps	**-**	**-**	2.6	-
Total derivative assets/(liabilities) held for non-trading purposes	**232.4**	**(315.0)**	425.5	(444.5)
Total recognised derivative assets/(liabilities)	**232.4**	**(315.0)**	425.5	(444.5)

The derivatives designated as cash flow hedges are interest rate swaps used to hedge interest rate risk in retail operations. Cash flows are hedged by quarterly time periods for durations up to 10 years. During the year there were no forecast transactions for which hedge accounting had previously been used but are no longer expected to occur.

In line with industry standards, credit valuation adjustments (CVAs) and debit valuation adjustments (DVAs) are applied to non-collateralised swaps representing the fair value measurement of counterparty risk. The net credit adjustment across the portfolio at the end of 2017 was £0.7m (2016: £1.1m). CVAs and DVAs are not applied to derivatives that are fully cash collateralised.

17. Equity shares

	Group and Bank	
	2017	2016
Investment securities:		
Listed	**0.3**	0.2
Unlisted	**26.3**	46.6
	26.6	46.8
Included above are the following unlisted trade investments:		
Unity Trust Bank – 1,130,000 ordinary shares of £1 each (2016: 1,130,000)	**2.3**	2.0
Visa International - 38,847 Series B Preference Shares (2016: 38,847)	**24.0**	19.3
VocaLink Holdings Limited – nil ordinary shares of £1 each (2016: 4,416,165)	**-**	25.3

Equity shares are classified as available for sale. The fair value of Visa International preference shares has been remeasured based on the equity price of Visa International shares, discounted for the estimated amount of preference shares to be clawed back and an illiquidity discount. The valuation technique used to calculate the fair value of equity shares is set out in note 34 to the consolidated financial statements. In 2017, the Bank sold its shares in VocaLink Holdings Limited.

18. Intangible assets

		Group and Bank					
		2017			2016		
	Note	**Internally generated intangible assets**	**Other intangible assets**	**Total**	Internally generated intangible assets	Other intangible assets	Total
Cost							
At the beginning of the year		**162.8**	**41.8**	**204.6**	243.4	46.0	289.4
Additions		**18.0**	**4.3**	**22.3**	26.5	-	26.5
Disposals		**-**	**-**	**-**	(66.5)	(4.2)	(70.7)
Impairment	9	**(3.1)**	**-**	**(3.1)**	(40.6)	-	(40.6)
Merger fair value write off[1]		**-**	**(41.8)**	**(41.8)**	-	-	-
Write off of fully amortised assets		**(4.1)**	**-**	**(4.1)**	-	-	-
Transfer between categories[2]		**(11.0)**	**11.0**	**-**	-	-	-
At the end of the year		**162.6**	**15.3**	**177.9**	162.8	41.8	204.6
Accumulated amortisation and impairment							
At the beginning of the year		**73.5**	**31.0**	**104.5**	115.6	31.0	146.6
Charge for the year	9	**24.3**	**6.9**	**31.2**	24.9	4.2	29.1
Disposals		**-**	**-**	**-**	(67.0)	(4.2)	(71.2)
Merger fair value write off[1]		**-**	**(35.2)**	**(35.2)**	-	-	-
Write off of fully amortised assets		**(4.1)**	**-**	**(4.1)**	-	-	-
Transfer between categories[2]		**(4.0)**	**4.0**	**-**	-	-	-
At the end of the year		**89.7**	**6.7**	**96.4**	73.5	31.0	104.5
Net book value							
At the end of the year		**72.9**	**8.6**	**81.5**	89.3	10.8	100.1
At the beginning of the year		**89.3**	**10.8**	**100.1**	127.8	15.0	142.8

1. The remaining Britannia merger fair value has been written off in 2017. Refer to note 34 to the consolidated financial statements - Fair values of financial assets and liabilities for further information.
2. This relates to a reclassification of assets classified as internally generated, which were externally generated.

Internally generated assets include £18.1m (2016: £17.1m) of assets in the course of construction.

Other intangible assets wholly consist of purchased software licences.

19. Property, plant and equipment

2017	Note	Group and Bank Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost						
At the beginning of the year		**22.0**	**-**	**35.6**	**9.3**	**66.9**
Additions		**3.5**	**-**	**0.2**	**17.1**	**20.8**
Disposals		**(3.6)**	**-**	**-**	**-**	**(3.6)**
Impairment	9	**-**	**-**	**-**	**(0.5)**	**(0.5)**
Merger fair value write off[1]		**(1.1)**	**-**	**-**	**-**	**(1.1)**
Write off of fully depreciated assets		**-**	**-**	**(2.8)**	**-**	**(2.8)**
Classified as held for sale		**(3.5)**	**-**	**-**	**-**	**(3.5)**
Transfer between categories		**(1.2)**	**14.6**	**7.7**	**(21.1)**	**-**
At the end of the year		**16.1**	**14.6**	**40.7**	**4.8**	**76.2**
Accumulated depreciation						
At the beginning of the year		**8.0**	**-**	**23.5**	**-**	**31.5**
Charge for the year	9	**0.5**	**-**	**3.7**	**-**	**4.2**
Disposals		**-**	**-**	**-**	**-**	**-**
Merger fair value write off[1]		**(0.4)**	**-**	**-**	**-**	**(0.4)**
Write off of fully depreciated assets		**-**	**-**	**(2.8)**	**-**	**(2.8)**
Classified as held for sale		**(0.7)**	**-**	**-**	**-**	**(0.7)**
Transfer between categories		**(1.2)**	**-**	**1.2**	**-**	**-**
At the end of the year		**6.2**	**-**	**25.6**	**-**	**31.8**
Net book value						
At the end of the year		**9.9**	**14.6**	**15.1**	**4.8**	**44.4**
At the beginning of the year		**14.0**	**-**	**12.1**	**9.3**	**35.4**

1. The remaining Britannia merger fair value has been written off in 2017. Refer to note 34 to the consolidated financial statements - Fair values of financial assets and liabilities for further information.

2016	Note	Group and Bank Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost						
At the beginning of the year		30.8	23.7	100.6	2.3	157.4
Additions		2.6	-	3.1	7.5	13.2
Disposals		(5.2)	(23.7)	(68.1)	-	(97.0)
Write off of fully depreciated assets		-	-	-	-	-
Classified as held for sale		(6.2)	-	-	-	(6.2)
Impairment	9	-	-	-	(0.5)	(0.5)
Transfer between categories		-	-	-	-	-
At the end of the year		22.0	-	35.6	9.3	66.9
Accumulated depreciation						
At the beginning of the year		8.4	23.6	79.3	-	111.3
Charge for the year	9	4.3	-	7.7	-	12.0
Disposals		(2.7)	(23.6)	(63.5)	-	(89.8)
Write off of fully depreciated assets		-	-	-	-	-
Classified as held for sale		(2.0)	-	-	-	(2.0)
Transfer between categories		-	-	-	-	-
At the end of the year		8.0	-	23.5	-	31.5
Net book value						
At the end of the year		14.0	-	12.1	9.3	35.4
At the beginning of the year		22.4	0.1	21.3	2.3	46.1

	Group and Bank	
	2017	2016
The net book value of land and buildings comprises:		
Freehold	**8.5**	12.7
Leasehold	**1.4**	1.3
	9.9	14.0

20. Other assets

	Group and Bank	
	2017	2016
Amounts recoverable within one year:		
Other assets	**19.3**	0.5
Amounts owed by Co-operative Group	**-**	13.0
Deferred consideration receivable	**-**	5.3
Amounts recoverable after more than one year:		
Amounts owed by Co-operative Group	**71.6**	73.9
Deferred consideration receivable	**4.4**	4.0
	95.3	96.7

Amounts owed by Co-operative Group includes a surrendered loss debtor of £71.6m (2016: £84.1m). Further details of the related party relationship with Co-operative Group and its undertakings are contained in note 32 to the consolidated financial statements.

21. Prepayments and accrued income

	Group and Bank	
	2017	2016
Amounts recoverable within one year	**24.1**	24.1
Amounts recoverable after more than one year	**0.6**	4.6
	24.7	28.7

22. Deposits by banks

	Group and Bank	
		Re-presented[1]
	2017	2016
Items in course of collection	**-**	20.5
Deposits from other banks	**1,122.7**	999.5
	1,122.7	1,020.0

1. Following a review of our documentation, obligatory netting arrangements were found to be in place for repos and reverse repos transactions. As a result the amount reduced by netting is £300.0m (2016 Re-presented: £178.6m), with the opposing impact in Loans and advances to banks in note 13 to the consolidated financial statements.

Included within deposits from other banks are liabilities of £1,120.5m (2016 Re-presented: £990.6m) secured on investment securities with a carrying value of £1,206.3m (2016: £1,260.1m) which have been sold under sale and repurchase agreements note 34 to the consolidated financial statements). Items in course of collection is £nil in 2017 as the unpresented cheques have been reclassified to Cash in order to more fairly reflect their nature.

23. Debt securities in issue

Cross currency interest rate swaps protect from changes in exchange rates and interest rates on debt securities in issue. Where appropriate, fair value hedge accounting is applied to reduce the accounting volatility from these positions.

Debt securities in issue include fixed and floating rate notes, all of which are now secured on portfolios of variable and fixed rate mortgages. Some of these notes (securitisations) are redeemable in part being limited to the net capital received from mortgagors in respect of the underlying assets and payments made when the securitisations unwind. There is no obligation to make good any shortfall out of general funds. Other notes (covered bonds secured and certificates of deposit) require contractual amounts due on specified maturity dates to be repaid.

Movement in the balance is as a result of settling £400.0m medium term notes and approximately £500.0m in relation to the redemption of Leek Finance Number Nineteen plc.

24. Other borrowed funds

The Restructuring and Recapitalisation resulted in the completion of a debt for equity swap. As such, the subordinated notes were extinguished. This is discussed in further detail in note 2.1 to the consolidated financial statements.

25. Other liabilities

	Group and Bank	
	2017	2016
Amounts falling due within one year:		
ATM creditor	**3.1**	4.6
Other creditors	**27.1**	32.4
Amounts falling due after one year:		
Other creditors	**4.5**	8.9
	34.7	45.9

Other creditors include finance lease obligations as follows:

	Group and Bank			
	Present value of lease payments		Future minimum lease payments	
	2017	2016	**2017**	2016
Due within one year	**-**	-	**-**	-
Due between one year and five years	**0.1**	0.1	**0.1**	0.1
Due after five years	**1.2**	1.3	**1.4**	1.5
	1.3	1.4	**1.5**	1.6

The future minimum lease payments have been discounted at LIBOR (London Interbank Offered Rate) over the term of the lease to give the present value of these payments.

26. Accruals and deferred income

	Group and Bank	
	2017	2016
Amounts falling due within one year	**57.0**	81.8
Amounts falling due after one year	**23.0**	33.5
	80.0	115.3

27. Provisions for liabilities and charges

		Group and Bank						
2017	Note	**Property**	**FSCS levies**	**PPI**	**Conduct/ legal**	**Separation**	**Other**	**Total**
At the beginning of the year		**32.7**	**6.6**	**90.4**	**78.9**	**27.3**	**40.5**	**276.4**
Provided/(released) in the year:								
Interest income		**-**	**-**	**-**	**0.4**	**-**	**-**	**0.4**
Operating expense	9	**(0.3)**	**-**	**-**	**1.0**	**(4.0)**	**19.9**	**16.6**
Provision for customer redress		**-**	**-**	**38.5**	**(11.5)**	**-**	**-**	**27.0**
Utilised during the year		**(10.9)**	**(4.2)**	**(40.0)**	**(35.9)**	**(23.3)**	**(47.9)**	**(162.2)**
At the end of the year		**21.5**	**2.4**	**88.9**	**32.9**	**-**	**12.5**	**158.2**
Provisions were analysed as follows:								
Amounts falling due within one year		**12.4**	**2.4**	**50.0**	**29.2**	**-**	**12.1**	**106.1**
Amounts falling due after one year		**9.1**	**-**	**38.9**	**3.7**	**-**	**0.4**	**52.1**
Total provisions		**21.5**	**2.4**	**88.9**	**32.9**	**-**	**12.5**	**158.2**

		Group and Bank						
2016	Note	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year		43.7	10.8	87.0	268.7	64.3	24.7	499.2
Provided/(released) in the year:								
Interest income		-	-	-	2.3	-	-	2.3
Operating expense	9	1.0	4.9	-	0.2	16.2	39.1	61.4
Provision for customer redress		-	-	36.0	(13.6)	-	-	22.4
Utilised during the year		(12.0)	(9.1)	(32.6)	(178.7)	(53.2)	(23.3)	(308.9)
At the end of the year		32.7	6.6	90.4	78.9	27.3	40.5	276.4

Provisions were analysed as follows:							
Amounts falling due within one year	16.1	6.6	34.1	71.3	27.3	31.3	186.7
Amounts falling due after one year	16.6	-	56.3	7.6	-	9.2	89.7
Total provisions	32.7	6.6	90.4	78.9	27.3	40.5	276.4

Property

There are a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases. In addition, dilapidation provisions are recorded to the extent that dilapidations have been incurred and/or the dilapidation clause within the contract has been invoked. During the year there was a net release of £0.3m (2016: £1.0m net charge).

Financial Services Compensation Scheme (FSCS) levies

In common with other regulated UK deposit takers, the levies are paid to the FSCS to enable the FSCS to meet claims against it. During 2008 and 2009 claims were triggered against the FSCS in relation to a number of financial institutions. The compensation paid out to consumers is currently funded through loans from HM Treasury, and these deposit takers could be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury. The ultimate FSCS levy to the industry as a result of the historic claims cannot currently be estimated reliably as it is dependent on various uncertain factors including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

By virtue of its holding deposits protected under the FSCS scheme there is an obligation to pay levies in respect of the interest cost for 2017/18 scheme year. The interest rate chargeable on the loan and levied to the industry is subject to a floor equal to the higher of HM Treasury's own cost of borrowing and Sterling LIBOR with 12-month maturity.

£2.4m has been provided as at 31 December 2017 (31 December 2016: £6.6m) for the share of the levies raised by the FSCS. The Group interest levy provision calculation includes estimates of the total FSCS levy in each levy year and estimates of the proportion of market participation in each levy year.

Payment Protection Insurance (PPI)

Provisions have been made in respect of potential customer compensation claims relating to past sales of PPI. Claims are investigated on an individual basis and, where appropriate, compensation payments are made. For a number of years, along with many other financial services providers, PPI was sold alongside mortgage and non-mortgage credit products. Sales of non-mortgage PPI were stopped in January 2009 and sales of mortgage PPI were stopped in March 2012.

An additional provision of £38.5m was recognised in the year (2016: £36.0m), in respect of the total expected cost of carrying out work and paying compensation related to historical PPI selling. The provision increase reflects increased complaint volumes ahead of the FCA imposed timebar of August 2019, the impact of marketing campaigns and the requirement to mail all previously rejected Plevin complaints. As a result, the total provision raised to date is £498.3m.

Conduct/legal provisions

During the period £0.4m (2016: £2.3m) has been provided in respect of interest income in relation to breaches of the technical requirements of the CCA.

A net release of £11.5m (31 December 2016: £13.6m) has been made for provision for customer redress. This includes a £0.5m (2016: £12.5m) net release on breaches of the technical requirements of the CCA as the remediation programme nears completion. There was a further release of £11.0m (2016: £15.3m) on other projects including mortgage issues of £9.6m (2016: £14.2m net charge). The legacy Mortgage issues covered in the previous years have been completed or reviewed in detail resulting in a reduced overall impact. A few residual mortgage issues remain under review with the current expectation of low to zero redress requirements. There has been no change to the Package Bank account programme as proactive remediation work coming to completion and inbound complaints volumes and average redress remain in line with expectations.

Other
Other provisions include provisions for severance costs, Pace separation and professional fees in relation to the Restructuring and Recapitalisation. Provisions are made where there is a present obligation and it is probable that expenditure will be made.

During 2017, £0.8m was released for provisions previously made in respect of two long term incentive plans for Senior Executives, established in 2015 and 2016. This reflects the lower anticipated pay out from these plans, as a result of plan performance against specified metrics, the fall in the Bank Company's share price and the re-calculation of awards, based on new Holding Company shares. Accordingly a provision of £0.2m is included in the financial statements as at 31 December 2017 (31 December 2016: £0.6m). There was no long term incentive plan set up in 2017.

For separation provision see note 2.5 to the consolidated financial statements.

28. Deferred tax

The movements on deferred tax are as follows:

	Group and Bank					
	2017			2016		
	Deferred tax asset	**Deferred tax liability**	**Total**	Deferred tax asset	Deferred tax liability	Total
Deferred tax at the beginning of the year	**-**	**(14.2)**	**(14.2)**	7.6	(47.8)	(40.2)
Credited/(charged) to the income statement:						
Current year	**13.3**	**14.0**	**27.3**	8.6	32.8	41.4
Prior year	**-**	**-**	**-**	(5.5)	-	(5.5)
Impact of corporation tax rate charge	**(2.2)**	**-**	**(2.2)**	(2.1)	0.8	(1.3)
	11.1	**14.0**	**25.1**	1.0	33.6	34.6
Credited/(charged) to other comprehensive income:						
Available for sale	**4.6**	**-**	**4.6**	2.5	-	2.5
Cash flow hedges	**8.8**	**-**	**8.8**	(7.3)	-	(7.3)
Pension reserve	**(20.3)**	**-**	**(20.3)**	(3.8)	-	(3.8)
	(6.9)	**-**	**(6.9)**	(8.6)	-	(8.6)
Deferred tax at the end of the year	**4.2**	**(0.2)**	**4.0**	-	(14.2)	(14.2)

The deferred tax asset above includes an offset for those deferred tax liabilities that are permissible to be offset.

	Group and Bank			
	2017		2016	
	Deferred tax asset	**Deferred tax liability**	Deferred tax asset	Deferred tax liability
Deferred tax comprises:				
Capital allowances on fixed assets and assets leased to customers	**59.6**	**-**	37.1	-
Fair value adjustment - The Co-operative Bank subsidiaries	**-**	**(0.2)**	-	(11.7)
Pensions and post-retirement benefits	**(39.4)**	**-**	(5.1)	-
Cash flow hedges	**(10.0)**	**-**	(17.4)	-
Unrealised appreciation on investments	**(6.2)**	**-**	(11.8)	-
Available for sale	**(4.0)**	**-**	(2.8)	(2.5)
Tax losses carried forward	**4.2**	**-**	-	-
	4.2	**(0.2)**	-	(14.2)

The deferred tax liability of £0.2m (2016: £11.7m) relating to fair value adjustments is net of a deferred tax asset of £nil (2016: £5.3m). The deferred tax charge/(credit) in the income statement comprises:

	Group and Bank	
	2017	2016
Capital allowances on fixed assets and assets leased to customers	**(22.4)**	(16.7)
Fair value adjustment - The Co-operative Bank subsidiaries	**(11.5)**	(33.2)
Cash flow hedges	**1.3**	(1.1)
Unrealised appreciation on investments	**0.1**	3.8
Pensions and post-retirement benefits	**14.1**	1.3
Other temporary differences	**(2.5)**	7.3
Capital losses	**-**	4.0
Tax losses carried forward	**(4.2)**	-
	(25.1)	(34.6)

Deferred tax assets totalling £412.3m (2016: £409.0m) have not been recognised where doubt exists over the availability of sufficient future taxable profits. Deferred tax has not been recognised in respect of trading losses of £2,069.2m (with deferred tax of £372.8m) and other temporary differences of £158.1m (with deferred tax of £39.5m).

The UK corporation tax rate reduced from 20% to 19% (effective from 1 April 2017) and will reduce further to 17% effective from 1 April 2020; the latter rate change was enacted on 15 September 2016. A banking surcharge tax of 8% also applies to the Bank (effective from 1 January 2016). Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

New legislation was enacted in 2016 with the effect that from 1 April 2016, only 25% of a bank's taxable profits can be relieved by brought forward losses. The Government announced on 16 March 2016 that further changes to the rules on the utilisation of tax losses will be introduced effective from 1 April 2017. These changes were enacted on 16 November 2017.

29. Pensions

This note has been prepared on a Group basis, however is equally applicable to the Bank.

Pensions charge

The pension charge in the income statement at 31 December 2017 was £14.7m (2016: £16.0m) which includes £5.0m (2016: £5.0m) in respect of the contribution to the Pace deficit recovery charge.

The pension charge relates to staff costs charges of £12.7m (see note 10 to the consolidated financial statements), £2.4m of admin expenses and £0.2m of interest expense, partially offset by £0.6m of interest income.

Included also within the income statement is a one off gain of £51.9m relating to a change to the index used to determine inflationary increases for pensions in payment from the scheme, from RPI to CPI representing a plan amendment. Further details are disclosed in b(i).

a) The Co-operative Pension Scheme (Pace)

The Group participates in Pace, a hybrid scheme, consisting of a closed defined benefit section (Pace Complete) and a defined contribution section (Pace DC). The Pace scheme is considered to be a multi-employer scheme under IAS 19 Employee benefits (revised 2011) with Co-operative Group being the Principal Employer.

In October 2015, Pace Complete closed to new members. Benefits built up in the scheme have been preserved and remain in the scheme with annual increases being applied in line with the scheme rules. From 1 October 2015, members in Pace Complete automatically began building up benefits in Pace DC, unless they opted out.

i. Scheme background

At 31 December 2012 the scheme was recognised as a group plan, since risks were shared between entities under the common control of Co-operative Group. The Group accounted for the scheme on a defined contribution basis since there was no contractual agreement or stated Co-operative Group policy for charging the net defined benefit cost for the scheme as a whole to individual participating entities. Therefore, the Group did not recognise its share of the net defined benefit cost. The net defined benefit cost of the pension scheme was recognised fully by the sponsoring employer, which was Co-operative Group Limited.

On 4 November 2013, Co-operative Group and the Group entered into an undertaking pursuant to which Co-operative Group agreed, subject to certain exceptions, not to require the Bank to cease to participate in Pace in connection with the 2013 LME or any subsequent reduction in Co-operative Group's shareholding in the Group (including to nil).

During 2017, discussions continued with Co-operative Group and the Pace Trustee and agreed Heads of Terms to sectionalise the Group's element of Pace, which will effectively separate its assets and liabilities in the scheme from those of other participating employers and remove the Group's 'last man standing' obligation to the rest of the Pace scheme. The principles laid out on the Heads of Terms have been further supplemented by an Implementation Agreement reached between the three parties in January 2018, and sectionalisation of the scheme is anticipated during 2018. Pace is not yet sectionalised and continues to operate on a 'last man standing' basis.

ii. Risks arising from the scheme

As a multi-employer pension scheme, Pace exposes the participating businesses to actuarial risks associated with the current and former employees of the Group and other participating employers until such a time that either the Group's share of the scheme assets and liabilities are separated, or the Group exits the scheme completely.

There are, for example, liabilities in Pace relating to benefits accrued by members whilst employed by CFSMS and working in the Group's business. On 23 January 2014, following the legal separation from the wider Co-operative Group, employment contracts for the majority of those employees who spent most of their time working on behalf of the Group were transferred from CFSMS to the Group. This increased the number of Group employees participating in the Pace scheme in 2014.

There are also 'orphan liabilities' in Pace that do not relate to any current employer participating in Pace. The extent to which the Group could be liable for funding Pace liabilities will depend, inter alia, on what position is reached as to the Pace liabilities properly attributable to the Group following implementation of the methodology agreed through the Heads of Terms and subsequent Implementation Agreement.

Pace is not yet sectionalised and continues to operate on a 'last man standing' basis. Prior to sectionalisation, in the event that other participating employers become insolvent and the full statutory debt is not recovered on insolvency, the Group would become liable for the remaining liabilities. Prior to sectionalisation, there is no agreed allocation of a deficit or surplus on (i) wind up of the plan; or (ii) the entity's withdrawal from the plan.

Therefore it has been concluded that there continues to be insufficient information available to consistently and reliably identify the Group's share of Pace liabilities and employer costs. For this reason the pension costs in respect of Pace are accounted for on a defined contribution basis in accordance with IAS 19 (revised 2011) and are recognised as an expense in the income statement, as explained below.

The key aspects of Pace are illustrated below.

iii. Scheme information

The Pace Trustee, in consultation with Co-operative Group, is responsible for the risk management arrangements for Pace, agreeing suitable contribution rates, investment strategy and for taking appropriate professional advice as required. There is exposure to potential future increases in required contributions and capital held for pension risk, reflecting the outcomes of the actuarial valuation and strategies employed by the scheme, which are assessed under the RMF.

iv. Contribution payments

On an accounting basis Pace reported a surplus of £1,783m as at 31 December 2016, which at the date of this report is the most recent accounting valuation available. Under the current arrangements the Group does not have an unconditional right of refund of scheme assets on winding up or any right to reduction of contributions as a result of this surplus.

The Pace triennial valuation as at 5 April 2016 was completed on 30 November 2017. The funding position for the entire scheme had improved from a £600.0m deficit per the previous triennial valuation as at 5 April 2013 to a surplus of £251.0m as at 5 April 2016. The level of funding for the Pace scheme is agreed between Co-operative Group and the Pace Trustee. As separation negotiations continue a further £5.0m contribution has been made into the scheme during 2017 (2016: £5.0m). On sectionalisation of the scheme, the level of funding required for the Group Section of the scheme will be agreed with the Pace Trustee.

Contributions are also paid in respect of the employed members of the defined contribution section of the scheme. Members can choose to pay up to a maximum core contribution of 8% of salary 'double-matched' up to a maximum member contribution of 5%. So, for members paying 5% or more, a contribution of 10% of salary is paid into the scheme.

b) Britannia Pension Scheme

The Britannia Scheme is a defined benefit scheme.

i. Scheme Background and risks arising from the scheme

In 2009, following the transfer of engagements of Britannia Building Society, CFSMS, a Co-operative Group subsidiary, became principal employer of the scheme, and the three other participating employers of the Britannia Scheme were Group wholly owned subsidiary entities.

The scheme closed on 6 October 2010 with active members at the date of closure being invited to join the relevant defined benefit or contribution Co-operative Pension Scheme for future pension accrual. No future service contributions are payable to the scheme due to the closure of the scheme to future accrual. The Trustee agreed to wind up the defined contribution section from February 2013, with any remaining members given the option of transferring their funds to an alternative approved pension arrangement, or secured benefits with an insurance contract. The weighted average duration of the defined benefit obligation of the Britannia Scheme is 23 years.

At 31 December 2012 the scheme was recognised as a group plan since all participating entities were within common control of Co-operative Group. The Group and its subsidiary entities participating in the scheme at the time (Platform, WMS and Britannia International) accounted for the scheme on a defined contribution basis, recognising the contribution paid as an expense in the income statement. Following separation of the Bank Company and its subsidiaries from the wider Co-operative Group as a result of the LME in 2013, the scheme was considered to be a multi-employer scheme under IAS 19 (revised 2011). At 31 December 2013 there was not sufficient information to reliably and consistently measure the share of the obligation and therefore the scheme was accounted for on a defined contribution basis. During 2014, employment contracts for those employees who spent the majority of their time working on behalf of the Bank were transferred from CFSMS to the Bank. As a result of this transfer, whilst CFSMS remained the sponsoring employer of the scheme, the total assets and liabilities of the scheme were recognised on the balance sheet as at 31 December 2014.
On 23 December 2015, a Flexible Apportionment Arrangement (FAA) was executed, at which time the Bank was named as a participating employer and a subsidiary replaced CFSMS as the principal employer, following which, CFSMS, WMS and PHL departed from the scheme. As the total assets and liabilities of the scheme were already recognised on the balance sheet, due to a guarantee provided, the FAA did not have a significant impact on the exposure to the risks of the scheme.

A change to the scheme rules was effective from 30 June 2016 which allowed the Group to recover a refund of surplus at the end of the scheme's life when there are no members remaining. On this basis the asset restriction under IFRIC 14 was removed.

At 31 December 2017, a net pension asset of £157.7m (2016: £20.3m) was recognised on the balance sheet in relation to the scheme. This net increase relative to the prior year was primarily driven by changes to demographic assumptions, a change to the index used to determine inflationary increases for pensions in payment from the scheme, from RPI to CPI (which is considered to represent a plan amendment and has given rise to a £51.9m one-off gain in the income statement in 2017) and scheme experience over the period, which has seen liabilities reduce, partly offset by the impact of a reduction in the discount rate as well as other factors. In addition, a £3.5m (2016: £3.7m) liability is recognised representing unfunded pension liabilities of the Britannia Supplementary Pension and Life Assurance Plan (BSPLAP). Benefits under this unfunded arrangement are valued on the same assumptions as the Britannia Scheme and are disclosed as unfunded obligations.

ii. Nature of benefits
The Britannia Scheme pays out pensions at retirement based on service to 6 October 2012 and final pay for employees who commenced employment prior to 1 September 2001, when it closed to new members.

iii. Funding the liabilities
Britannia Pension Trustees Limited is the corporate body that acts as 'Trustee' of the Britannia Scheme. UK legislation requires the Trustee to carry out valuations at least every three years and to target full funding against a basis that prudently reflects the scheme's risk exposure. The actuarial valuation of the Britannia Scheme as at 5 April 2017, completed by the Scheme Actuary in accordance with the scheme specific funding requirements of the Pensions Act 2004, showed the Britannia Scheme had a surplus of £1.7m. As a result, it has been agreed with the Trustee that no further deficit recovery contributions will be required at this time; however, the provision of security to the scheme will be maintained. This is in the form of £165.1m AAA rated retained Warwick Finance Two securitisation notes, with a 17% haircut. This security becomes enforceable in the event that deficit recovery payments are not met, as may be agreed with the Trustee in the future, insolvency or the failure to adhere to terms of the security deed.

The liabilities for the accounting disclosures have been calculated based upon rolling forward the valuation results at 5 April 2017 from the valuation date to the measurement date.

iv. Governance
The Chair of the Trustee Board is appointed by and from the Trustee Directors and the Board comprises an Independent Trustee, nominees of the Group and elected scheme Members. The Trustee, in consultation with the Group, is responsible for the risk management arrangements for the Britannia Scheme, agreeing suitable contribution rates, investment strategy and for taking professional advice as appropriate.

v. Risks associated with the Scheme
Risks arising in the Britannia Scheme are identified and assessed under the Risk Management Framework. Exposure exists to potential future increases in required contributions, based upon future actuarial valuations, and capital held for pension risk based upon the assessment of risks to the balance sheet posed by the scheme.

Actions taken by the Pensions Regulator, changes to European legislation, or changes in financial strength could result in stronger funding standards, which could materially affect the cash flow and balance sheet. There is also a risk that changes in the assumptions for life expectancy, interest rates or in price inflation could result in a deficit in the scheme. Other assumptions used to value the defined benefit obligation are also uncertain, although their effect is less material.

vi. Investment strategy
Some risk arises from the Britannia Scheme defined benefit section because the value of the asset portfolio and returns from it may be less than expected. There is also a risk of a mismatch between the scheme's assets and liabilities and differences in sensitivity to changes in financial and demographic factors. The Trustee's objective is to invest the scheme's assets in the best interest of the members and beneficiaries. Within this framework the Trustee has agreed a number of objectives to help guide them in their strategic management of the assets and control of the various risks to which the Britannia Scheme is exposed.

The key aspects of the defined benefit section of the Britannia Scheme are as follows:

	2017	2016
The principal assumptions used to determine the defined benefit liabilities of the Britannia Pension Scheme are:		
Discount rate	**2.40%**	2.70%
Revaluation in deferment (CPI)	**2.10%**	2.30%
Future pension increases where capped at 5.0% per annum	**2.10%**	3.20%
Future pension increases where capped at 5.0% per annum, minimum 3.0%	**3.20%**	3.65%
The principal assumptions used to determine the net pension cost of the Britannia defined benefit scheme are:		
Discount rate	**2.70%**	3.90%

The average life expectancy (in years) for mortality tables used to determine defined benefit scheme liabilities for the former Britannia Building Society scheme at the 2017 year end is:

	Male	**Female**
Life expectancy:		
Member retiring today (member age 60)	**27.0**	**29.0**
Member retiring in 20 years (member age 40 today)	**28.8**	**30.9**

	Group and Bank	
	2017	2016
Fair value of plan assets	**792.6**	854.9
Present value of funded obligations	**(634.9)**	(834.6)
	157.7	20.3
Present value of unfunded obligations	**(3.5)**	(3.7)
	154.2	16.6

The amounts recognised in the income statement are as follows:

	Group and Bank	
	2017	2016
Interest expense on defined benefit obligation	**(21.1)**	(24.2)
Interest income on plan assets	**21.7**	27.4
Interest expense on effect of onerous liability	**-**	(1.6)
Total net interest income	**0.6**	1.6
Administrative expenses	**(2.3)**	(2.1)
Past service cost	**51.9**	-
Defined benefit costs included in income statement	**50.2**	(0.5)

Changes in the present value of the defined benefit obligation are as follows:

	Group and Bank	
	2017	2016
Defined benefit obligation at the start of the year	**834.6**	639.9
Past service cost	**(51.9)**	-
Interest expense	**21.1**	24.2
Benefit payments from plan assets	**(108.9)**	(42.0)
Remeasurements:		
Effect of changes in demographic assumptions	**(55.9)**	-
Effect of changes in financial assumptions	**35.7**	212.5
Effect of experience assumptions	**(39.8)**	-
Defined benefit obligation at the end of the year	**634.9**	834.6

	Group and Bank	
	2017	**2016**
Fair value of plan assets at the start of the year	**854.9**	720.3
Interest income	**21.7**	27.4
Employer contributions	**6.0**	5.9
Benefit payments from plan assets	**(108.9)**	(42.0)
Administrative expenses paid from plan assets	**(2.3)**	(2.1)
Return on plan assets (excluding interest income)	**21.2**	145.4
Fair value of plan assets at the end of the year	**792.6**	854.9

The asset allocations at the year-end were as follows:

	2017	Re-presented[1] 2016
Equities	**97.8**	159.0
Debt instruments	**244.8**	592.5
Liability driven investments	**247.1**	-
Alternative growth	**114.2**	-
Property	**64.7**	67.2
Other	**24.0**	36.2

The table below shows the value of the assets in each category which have a quoted market price:

	2017	Re-presented[1] 2016
Equities	**97.8**	159.0
Debt instruments	**179.2**	539.3
Liability driven investments	**247.1**	-
Other	**24.0**	35.6

1. The comparative figures have been re-presented to more fairly reflect their nature.

Critical accounting estimates and judgements - sensitivity of defined benefit obligations

The measurement of the defined benefit liability is particularly sensitive to changes in certain key assumptions, which are described below. The methods used to carry out the sensitivity analyses presented below for the material assumptions are the same as those used previously. The calculations alter the relevant assumption by the amount specified, whilst assuming that all other variables remained the same. This approach is not necessarily realistic, since some assumptions are related; for example, if the scenario is to show the effect if inflation is higher than expected, it might be reasonable to expect that nominal yields on corporate bonds will increase also. However, it enables the reader to isolate one effect from another.

Discount rate	This has been selected following actuarial advice, taking into account the duration of the liabilities. An increase in the discount rate of 0.1% would result in a £13.9m decrease in the present value of the defined benefit obligation.
Inflation	Inflation is a significant assumption as it is used to determine pension increases before and after retirement. The assumption adopted is consistent with the discount rate adopted. A decrease in the inflation rate of 0.1% would result in a £11.8m decrease in the present value of the defined benefit obligation.
Mortality rates	The mortality assumptions adopted are based on those recommended by the actuaries that advise the scheme management and reflect the most recent information as appropriate. The impact on the deficit if members were assumed to live for one year longer against the current mortality assumption would increase the present value of the defined benefit obligation by £25.3m.

Bank (unfunded) pension scheme

The Bank also operates a small unfunded pension scheme.

	2017	2016
Price inflation rate (RPI)	**3.2%**	3.3%
Rate of increase in salaries	**N/A**	N/A
Discount rate	**2.4%**	2.7%

The assumptions used by the actuary were the best estimates chosen from a range of possible actuarial assumptions which, due to the timescales covered, may not necessarily be borne out in practice.

The values of the assets and liabilities of the unfunded pension scheme were:

	Group and Bank	
	2017	2016
Deficit in scheme	**(4.9)**	(5.2)
Analysis of amount charged to income statement:		
Interest expense on pension scheme liabilities	**0.1**	0.2

Changes in the present value of the scheme liabilities are as follows:

	Group and Bank	
	2017	2016
Opening defined benefit liabilities	**5.2**	4.4
Current service cost	**-**	-
Interest expense on liabilities	**0.1**	0.2
Actuarial (gains)/losses	**(0.2)**	0.8
Benefits paid	**(0.2)**	(0.2)
Closing defined benefit liabilities	**4.9**	5.2

Amounts recognised in the statement of comprehensive income

	Group and Bank	
	2017	2016
Actuarial (gains)/losses on scheme liabilities during the year	**(0.2)**	0.8
Total scheme gains/(losses) during the year	**(0.2)**	0.8

The amounts for the current year are as follows:

	Group and Bank	
	2017	2016
Defined benefit obligation	**(4.9)**	(5.2)
Deficit in scheme	**(4.9)**	(5.2)

The net retirement benefit liability of £11.3m on the consolidated balance sheet 31 December 2017 represents £3.5m relating to the unfunded pension liabilities of the Britannia Supplementary Pension and Life Assurance Plan (BSPLAP), £4.9m obligation relating to the unfunded Pension Promise and £2.9m liability recognised in respect of contributions in relation to Pace.

30. Contingent liabilities

This note has been prepared on a Group basis, however is equally applicable to the Bank.

The tables below provide the contractual amounts and risk weighted amounts of contingent liabilities and commitments. The contractual amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the CRD IV rules.

The contingent liabilities, as detailed below, arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Group and Bank			
	Audited	**Unaudited**	Audited	Unaudited
£'000	**Contractual amount 2017**	**Risk weighted amount 2017**	Contractual amount 2016	Risk weighted amount 2016
Contingent liabilities:				
Guarantees and irrecoverable letters of credit	**15.4**	**5.3**	12.1	4.6
Other commitments:				
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[1]	**2,263.2**	**265.3**	2,277.4	296.2
	2,278.6	**270.6**	2,289.5	300.8

1. Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,211.2m (2016: £1,376.2m).

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the day-to-day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirement. See note 34 to the consolidated financial statements for further details of assets pledged.

Commitments under operating leases

Various properties and equipment are leased under non-cancellable operating lease arrangements. The leases have various terms, ranging from six months to 999 years. None of these leases are individually material and none have any material clauses. The table below discloses the minimum operating lease payments that will be required over the remaining lives of the leases.

	Group and Bank	
£'000	**Land and buildings 2017**	Land and buildings 2016
Falling due:		
Within one year	**8.7**	12.2
Between one and five years	**25.8**	33.7
In five years or more	**72.2**	73.6
	106.7	119.5

A number of branch and office premises are leased under operating leases. The leases typically run for a period of up to 25 years, with an option to renew the lease after that period. Lease payments are generally reviewed every three to five years to reflect market rentals.

The total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases was £3.1m (2016: £4.2m).

Indemnification agreement

An indemnification agreement exists with CFS Management Services (CFSMS), part of Co-operative Group, which is accounted for as a guarantee under IFRS 4, in which CFSMS is indemnified against all and any liability, loss, damage, costs and expense arising from the agreement (under which CFSMS provides certain assets and services). This agreement will remain in place until it is terminated after separation activities with the wider Co-operative Group are fully completed, but this will require the consent of CFSMS.

There will continue to be VAT charges incurred in respect of any assets that are supplied under the CFSMS-Bank Services Agreement that are not owned by the Group, until separation is fully effected.

Separation costs agreement and IT services agreement

IT services are received from Co-operative Group Limited under an IT Services Agreement (ITSA) dated 5 July 2012. The services are provided on an 'at costs' basis and Co-operative Group Limited is managed as a provider of material services. The most recent amendment to the ITSA was made on 21 December 2016 permitting termination, in part for convenience, and a framework to manage the process of exit of services from the ITSA to new chosen suppliers. This framework is being used to exit progressively from the ITSA as services are transitioned from Co-operative Group to new suppliers.

An IT Separation Costs Agreement was entered into with Co-operative Group on 22 January 2015 as amended by a letter dated 20 June 2016 to support Separation of the legacy shared infrastructure. The IT Separation Costs agreement assessed the Group and Co-operative Group's respective costs to deliver Separation. Co-operative Banking Group Limited (as the parent of CFSMS) undertook to contribute a maximum of £95m towards such Co-operative Group costs, with the Group to make a contribution of up to £25m, based on a formula in the event that the total cost of this Co-operative Group project falls between £76m and £120m. Co-operative Group Limited and CSFMS undertook not to terminate the existing ITSA prior to 31 December 2017 to provide the Group sufficient time to separate its IT infrastructure from that of Co-operative Group Limited.

Conduct issues

Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a possibility that certain aspects of the current or historic business, including, amongst other things, mortgages and relationship banking, may be determined by the FCA and other regulatory bodies or the courts as, in their opinion, not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment.

In particular, there is currently a significant regulatory focus on the sale practices and reward structures that financial institutions have used when selling financial products. There may also be other regulatory investigations and action in the future in relation to conduct and other issues that the Group is not presently aware of, including investigations and actions against it resulting from alleged mis-selling of financial products or the ongoing servicing of those financial products. The outcome of any ongoing disputes and legal, regulatory or other investigations or proceedings is currently uncertain.

The Bank has a small number of mortgage issues that remain under review with current expectation of zero redress. These issues are on hold pending the outcome of recommendations to the FCA that redress will not be undertaken due to the high level of calculation complexity and very low incidence and quantum of customer detriment.

Sale of the Group's share in Visa Europe Limited (VE)
The sale of the share in VE completed on 21 June 2016. In connection with the transaction, the Group and certain other members of VE have entered into a Loss Sharing Agreement (LSA), on a several and not joint basis, to indemnify Visa Inc. (VI) for certain losses which may be incurred as a result of existing and potential litigation relating to the setting and implementation of domestic Merchant Interchange Fee (MIF) rates in the UK. This indemnification is up to a maximum amount of the upfront cash consideration to be received, being approximately €50m. For any such losses, the new arrangement under the LSA will replace the potential uncapped indemnity under the existing VE Operating regulations, which will otherwise continue for claims outside the UK. The Preference Stock, the LSA, and the continuation of the existing indemnity for claims outside the UK work together to provide Visa Inc. with protection against liabilities from MIF litigation in the VE territory. Overall losses would in the first instance be recovered by VI from the banks in the form of cancelling the preference shares issued as part of the consideration above.

The potential exists, therefore, for the value of the consideration in the form of preference shares (Preference Stock) to be eroded by liabilities incurred by Visa Inc. in connection with MIF litigation in the VE territory. For further fair value disclosures see note 34 to the consolidated financial statements.

Regulatory supervision and other investigations
There are a number of regulatory supervision and other investigations and enquiries into events at the Group and circumstances surrounding them. These include:

- The Treasury announced on 6 March 2018 the expected commencement of an independent review pursuant to their powers under the Financial Services Act 2012 into the prudential supervision of the Bank relating to the period 2008 -2013.
- The Financial Reporting Council (FRC) has launched an investigation under its Accountancy Scheme into the preparation, approval and audit of the Bank's accounts up to and including its 2012 annual accounts, which focuses on the role of the previous auditors and individual accountants. The FRC concluded its investigations into the then CEO during 2016, and the investigation in relation to previous auditors and the audit of the 2012 and prior financial statements is ongoing.

Co-operation continues with the investigating authorities. It is not possible to estimate the financial impact should any adverse findings be made.

Legal proceedings
Various other legal proceedings exist involving claims by and against, which arise in the ordinary course of business, including debt collection, mortgage enforcement, consumer claims and contractual disputes. It is not expected that the ultimate resolution of any of these proceedings will have a material adverse effect on the operating results, cash flows or the financial position and contingent liabilities have not been disclosed for these claims. Provisions have been recognised for those cases where there is an ability to reliably estimate the probable loss where the probable loss is not de minimis. See note 27 to the consolidated financial statements.

Mortgage securitisation representations and warranties (including Warwick Finance One, Two and Three)
In connection with the mortgage securitisations (including Warwick Finance One, Two and Three) and covered bond transactions, various representations and warranties relating to the mortgage loans are made, including in relation to ownership, compliance with legislation and origination procedures. If the representations and warranties are breached subject to any applicable materiality determination, repurchase of the affected mortgage loans or in some circumstances compensation to the securitisation vehicle may be required.

There is a risk that a number of the underlying matters giving rise to the conduct and legal provisions set out in note 27 to the consolidated financial statements could have given rise to breaches of such representations and warranties. Accordingly, there is a risk that compensation or repurchasing affected mortgage loans may be required in amounts that may reduce liquidity.

The extent cannot be estimated to which the matters described above, will be impacted, or how future developments may have a material adverse impact on the Bank's net assets, operating results or cash flows in any particular period.

Pensions
Refer to note 29 to the consolidated financial statements.

31. Investment in joint ventures
Investment in joint ventures is £6.3m (2016: Re-presented[1] £6.0m).

49% and 50% of the ordinary shares are owned in Britannia Personal Lending Limited (BPL) and Britannia New Homes (Scotland) Limited (BNH(S)) respectively, both registered in England and operating in the UK. BPL trades in the business of unsecured personal lending and BNH(S) trades in the construction of domestic buildings. Both are considered a joint venture as decisions about relevant activities require the unanimous consent of joint venturers and this is accounted for as such.

Britannia New Homes (Scotland) Limited has negative net assets (£1.7m) and therefore the 50% retained proportion is capped at nil to align to the carrying value of cost of investment in the entity.

Interest in BPL is as follows:

	2017	Re-presented[1] 2016
Current assets	**8.4**	9.4
Total Assets	**8.4**	9.4
Current liabilities	**2.1**	3.4
Equity	**6.3**	6.0
Total Liabilities and Equity	**8.4**	9.4
Income	**0.5**	0.6
Expenses	**-**	(0.2)
Profit before tax	**0.5**	0.4
Taxation	**(0.1)**	(0.1)
Profit after tax	**0.4**	0.3

1. Prior year figures have been re-presented to reflect solely the interest in BPL.

32. Related party transactions

This note has been prepared on a Group basis, however it is equally applicable to the Bank.

Parent, subsidiary and ultimate controlling party

As at 31 December 2017, the Group had two significant shareholders; SP Coop Investment, Ltd and Goldentree Asset Management Lux S.A.R.L., each holding over 20% of the B shares of the Holding Company, and therefore considered to be a related party.

Prior to the Restructuring and Recapitalisation, Co-operative Group was a significant shareholder in the Bank, and had the right to Bank Board representation. Therefore Co-operative Group has been considered a related party during the year up until the Restructuring and Recapitalisation on 1 September 2017, and there have been material transactions during this period.

Restructuring and Recapitalisation

Certain aspects of the arrangements with Co-operative Group and other current investors in the Group, relating to the Restructuring and Recapitalisation, have given rise to related party transactions in 2017. The arrangements are as follows:

- With a view to addressing the 'last-man standing' risk for the Group, the Group, Co-operative Group and the Trustee of Pace have entered into legally binding agreements which, when implemented, will effect sectionalisation of Pace such that the Group will become responsible for its own section of Pace only, and will no longer have 'last-man standing' risk for the rest of Pace;
- Co-operative Group and the Group have terminated the relationship agreement and co-existence principles; the Group has undertaken to ensure its brands are distinguishable from the brands of Co-operative Group; there have been amendments to the Tax Deed regarding arrangements with respect to the future sharing of recoveries realised by Co-operative Group from tax losses surrendered to it historically by the Group; and the Group has agreed to reimburse an amount up to £6.0m of Co-operative Group's advisers' fees incurred by it in connection with the Restructuring; and
- SP Coop Investment, Ltd and Goldentree Asset Management Lux S.A.R.L., both of which are disclosed as related parties in the Bank's 2016 Annual Report and Accounts and the Bank's Interim Financial Report 2017, and continued to be related parties at 31 December 2017 on account of holding greater than 20 percent of the B shares of the Holding Company, entered into certain arrangements with the Group in connection with the Restructuring and Recapitalisation as follows:
  - In exchange for their £78.9m creditor claim as a Noteholder, 64.7m pre-transaction shares in the Bank entity, £61.3m cash consideration, and premiums earned as part of the transaction, SP Coop Investment, Ltd received 1,717,344,448 A shares and 19 B shares in the Holding Company.
  - In exchange for their £69.5m creditor claim as a Noteholder, 60.8m pre-transaction shares in the Bank entity, £54.0m cash consideration, and premiums earned as part of the transaction, Goldentree Asset Management Lux S.A.R.L. received 1,489,980,873 A shares and 16 B shares in the Holding Company.
  - On behalf of an ad hoc committee of five Tier 2 noteholders, including SP Coop Investment, Ltd and Goldentree Asset Management Lux S.A.R.L., the Bank paid £8.1m of expenses. These amounts are included within the Restructuring and Recapitalisation costs recognised in the income statement. See note 2 to the consolidated financial statements for further details.

Pensions undertaking

The Co-operative Pension Scheme (Pace) and Britannia Pension Scheme are considered related parties due to the principal employer being Co-operative Group and the Bank respectively. For further details see note 29 to the consolidated financial statements.

Britannia Supplementary Pension & Life Assurance Plan (BSPLAP)

On 23 June 2016, the Bank entered into a Deed of Substitution, Removal and Appointment of Trustee and Cessation of Participation relating to the BSPLAP with CFS Management Services Limited (CFSMS, a subsidiary of Co-operative Group) and Co-operative Group. Under the Deed, CFSMS was released from its obligations and liabilities as the sole sponsor, principal employer and trustee of the BSPLAP and the Bank replaced it as sole sponsor, principal employer and trustee.

Other services

A Professional Services Master Agreement and related Service Contracts has been agreed with Co-operative Group to provide a range of corporate and HR services post-Separation (the Services). The majority of the services under the Services Agreement have now been repatriated to the Group, with the intention that the they were formally terminated in 2017 and the final few remaining will be terminated in line with the completion of the IT Separation (e.g. Datacenter Utility Services) or will be enduring arrangements depending on the Group's business (e.g. Membership Services).

See note 30 to the consolidated financial statements for details on the Agreements.

Transitional Services Letter (TSA)

Co-operative Group Limited and Bank entered into a TSA on 21 December 2016 whereby Co-operative Group Limited agreed to provide certain services into the IBM environment to ensure a successful separation of the IT infrastructure from Co-operative Group Limited.

CFSMS-Bank Framework Services Agreement

On 16 February 2006, the Bank and CFSMS entered into the CFSMS-Bank Services Agreement pursuant to which CFSMS provides assets such as office equipment, materials and office space, other facilities and services, and consultants who act as secondees to the Bank. An indemnity is provided to CFSMS for all liabilities, losses, damages, costs and expenses of any nature as a result of CFSMS entering into and performing the agreement in respect of the assets, services and personnel provided.

The Bank and CFSMS commenced unwinding this arrangement during 2014 with the transfer of employment of the majority of the staff to the Bank and the transfer of assets to the Bank. Numerous contracts have been entered into with third party suppliers to replace those services previously provided through CFSMS or the wider Co-operative Group. By the end of 2016 all known staff transfers had been completed and the vast majority of contracts re-established as 'Bank-only'. The remaining contracts will be transferred as they come due over the balance of the IT Separation period.

IT Security Services

A specialist IT security team provides an IT security service to the Co-operative Insurance Services General Insurance Limited (CISGIL) in relation to the shared IT infrastructure which the Group and Co-operative Insurance Services General Insurance Limited (CISGIL) share until such infrastructure is separated. This service comprises a small number of people.

Following the Transfer of Undertakings (Protection of Employment) 'TUPE' transfer of IT security personnel from CFSMS to the Bank in November 2014, a letter of agreement was entered into with CFSMS that regulated the terms on which certain IT security personnel would have transferred from CFSMS, and the terms on which an IT security service would be provided, akin to the transferred IT security personnel used to provide, in relation to the IT infrastructure which is shared with CFSMS.

Surrendered loss debtor

As part of the negotiations relating to the separation, terms were also agreed with Co-operative Group relating to the surrender of tax losses between the entities in the Bank's tax group and entities in Co-operative Group tax group. A deed sets out the basis of the agreement by Co-operative Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 2013 and the terms of the payment by Co-operative Group for those tax losses. The 2017 consolidated Financial Statements, which include a surrendered loss debtor of £71.6m (2016: £84.1m), have been prepared on a basis consistent with the deed. Payment is received from Co-operative Group when Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised. These amounts are included within Other Assets.

Reclaim Fund Limited (RFL)

The Chairman of the Audit Committee and Non-Executive Director, Glyn Smith, is also a Non-Executive Director of a not-for-profit subsidiary of Co-operative Group, Reclaim Fund Limited (RFL), from which Co-operative Group and the Group derive no financial benefit.

Participation in the Dormant Accounts Scheme is made through the Bank's participation in RFL alongside many other banks and building societies in the UK. Balances on dormant accounts (those that have been dormant or inactive for 15 years or more) are transferred to RFL. RFL was established in 2011 to implement a significant part of the Dormant Bank & Building Society Accounts Act (the Act). It is a not-for-profit company operating under its own regulatory authorisation from the FCA with an independent Board of Directors. The Act allows the transfer of money from dormant accounts to RFL for distribution to the Big Lottery Fund and other agencies for onward distribution to good causes across the UK. It also ensures that the rights of account holders are protected in perpetuity by transferring the claim against the Group to RFL.

During the year, £1.6m of gross balances were transferred to RFL relating to all new accounts which have become dormant or inactive (for 15 years or more) in the past year (2016: £1.1m).

Transactions with Co-operative Group

The tables below provide an analysis of transactions with Co-operative Group and its undertakings in the period to 31 December 2017 incurred in the ordinary course of business on normal commercial terms. As of 1 September 2017, Co-operative Group is no longer a related party of the Group having reduced its shareholding to less than 20 percent and therefore transactions since 1 September 2017 are not included. As at 31 December 2017 Co-operative Group has divested all of its shareholding in the Holding Company.

	Group and Bank			
	2017		2016	
	Interest and fees received	**Interest and fees paid**	Interest and fees received	Interest and fees paid
Co-operative Group Limited and its subsidiaries[1]	**1.7**	**0.5**	2.3	0.7
The Co-operative Banking Group Limited and its subsidiaries	**-**	**-**	0.2	0.1
	1.7	**0.5**	2.5	0.8

1. Co-operative Group Limited and its subsidiaries excludes The Co-operative Banking Group Limited and its subsidiaries sub-group

B Shareholders agreement

Following the completion of the Restructuring and Recapitalisation on 1 September 2017, the Bank Company's sole shareholder is The Co-operative Bank Holdings Limited. The Holding Company's share capital is divided into Class A ordinary shares of £0.0001 each and Class B redeemable preference shares of £0.01 each. Details of the rights of the A and B shareholders are detailed in the Ownership section of the Corporate Governance Report on page 35, as well as the details of the B Shareholders Agreement. Each and every B shareholder is entitled to receive notice of, attend and vote at a general meeting of the Holding Company, with one vote in respect of each B share registered in the name of the holder. The B shareholders are entitled to appoint up to two Directors to the Board of the Holding Company, and the Holding Company is entitled to appoint up to two Directors to the Board of the Bank, who are designated as B Directors of the Holding Company and Bank.

As at 31 December 2017, the B shareholders of the Holding Company were: SP Coop Investment, Ltd; Goldentree Asset Management Lux S.A.R.L.; Cyrus Opportunities Master Fund II Ltd; Invesco Asset Management Limited for and on behalf of its discretionary managed clients via The Bank of New York Nominees Limited; Anchorage Illiquid Opportunities Offshore Master V.L.P. SP Coop Investment, Ltd (28.79%) and Goldentree Asset Management Lux S.A.R.L. (22.73%) are deemed to be related parties as a result of each holding over 20% of the B shares in the Holding Company.

On 6 March 2018, Goldentree Asset Management Lux S.A.R.L. reduced its Class A shareholding in the Holding Company and as a result, it's entitlement to B shares reduced. As of that date, Goldentree Asset Management Lux S.A.R.L. which has been disclosed as a related party as at 31 December 2017, would no longer be considered a related party on account of holding less than 20% of the B shares of the Holding Company.

Transactions with other related parties

Key management personnel, as defined by IAS 24 (Related Party Disclosures), are considered to be the Board of the Group and Bank. The volume of related party transactions with key management is provided below:

Directors, key management personnel and close family members

	Group and Bank	
	2017	2016
Deposits and investments at the beginning of the year	**1.2**	0.5
Net movement	**(1.1)**	0.7
Deposits and investments at the end of the year	**0.1**	1.2

No Directors had loans or received any severance payments during the current or prior year.

Key management compensation

	Group and Bank	
	2017	2016
Salaries and short term benefits	**5.3**	4.2
	5.3	4.2

33. Share capital

Following the completion of the Restructuring and Recapitalisation and the creation of The Co-operative Bank Holdings Limited, share capital in the current period reflects the Group position. The comparative reflects the Bank position.

	Group			
	2017		2016	
	No. of shares (millions)	**Share capital**	No. of shares (millions)	Share capital
Allotted, called up and fully paid				
At the beginning of the year	**451.5**	**22.6**	451.5	22.6
Issued during the year	**9,029.1**	**0.9**	-	-
Share for share exchange	**(451.5)**	**(22.6)**	-	-
At the end of the year	**9,029.1**	**0.9**	451.5	22.6

	2017	2016
Share premium account		
At the beginning of the year	**1,736.9**	1,736.9
Premium on shares issued during the year	**313.8**	-
Share for share exchange	**(1,736.9)**	-
At the end of the year	**313.8**	1,736.9

On 13 July 2017, The Co-operative Bank Holdings Limited was incorporated with 451,457 ordinary shares of £0.10 each. On 1 September 2017, each incorporation share was sub-divided by 1,000 into 451,457,000 ordinary shares of £0.0001 each and reclassified as A shares. In addition, on 1 September 2017, The Co-operative Bank Holdings Limited became the new holding company for The Co-operative Bank plc and its subsidiaries by way of a share for share exchange with its shareholders. The Co-operative Bank Holdings Limited allotted and issued an additional 8,577,673,200 A shares of £0.0001 each and 65 fully paid B redeemable preference shares of £0.01 each to qualifying A shareholders as part of the Restructuring and Recapitalisation of The Co-operative Bank plc. The capital reorganisation reserve was recognised on the issuance of Holding Company shares in exchange for the acquisition of the entire share capital of The Co-operative Bank plc. The reserve reflects the difference between the consideration for the issuance of Holding Company shares and the Bank's share capital and share premium. Further details of the transactions are disclosed in note 2 to the consolidated financial statements.

Share for share exchange

On 1 September 2017, The Co-operative Bank Holdings Limited acquired the entire share capital of The Co-operative Bank plc which comprised of 451,456,510 £0.05 ordinary shares via a share for share exchange in return for 5% of the fully-diluted issued A Shares of the Holding Company.

The holders of the ordinary A shares do not hold any voting rights but are entitled to participate in distributions and to receive a dividend on liquidation. The B shareholders have one vote for every share held and also benefit from certain governance, notification and approval rights with respect to the new Holding Company group but will have no rights to distributions, other than on exit in an amount of £25m in aggregate, subject to achieving a minimum valuation threshold.

	Bank			
	2017		2016	
	No. of shares (millions)	**Share capital**	No. of shares (millions)	Share capital
Allotted, called up and fully paid				
At the beginning of the year	**451.5**	**22.6**	451.5	22.6
Issued during the year	**60.0**	**3.0**	-	-
At the end of the year	**511.5**	**25.6**	451.5	22.6

	2017	2016
Share premium account		
At the beginning of the year	**1,736.9**	1,736.9
Premium on shares issued during the year	**680.0**	-
At the end of the year	**2,416.9**	1,736.9

The Bank's existing ordinary shares have been transferred to the ownership of The Co-operative Bank Holdings Limited and The Co-operative Bank Holdings Limited has subscribed for a further 60,000,000 of £0.05 ordinary shares in the Bank as part of the Restructuring and Recapitalisation. 20,000,000 ordinary shares were issued in consideration for the equity capital raise of £250m (£1m share capital and £249m share premium) and 40,000,000 ordinary shares were issued in consideration for the release of £454.8m by the Holding Company and cancellation by the Bank of the Subordinated Notes (£2m share capital and £452.8m share premium). The number of ordinary shares in issue in the Bank at 31 December 2017 was 511,456,510 (2016: 451,456,510). The ordinary shareholders have one vote for every share held.

34. Fair values of financial assets and liabilities

This note has been prepared on a Group basis, however is equally applicable to the Bank.

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

	Group						
Balance sheet categories	**Held for trading**	**Designated at fair value**	**Loans and receivables**	**Available for sale**	**Liabilities at amortised cost**	**Derivatives in a hedging relationship**	**Total**
2017							
Assets							
Cash and balances at central banks	-	-	4,032.1	-	-	-	4,032.1
Loans and advances to banks	-	-	574.8	-	-	-	574.8
Loans and advances to customers	3.2	175.0	16,566.3	-	-	-	16,744.5
Investment securities	-	-	100.0	2,287.7	-	-	2,387.7
Derivative financial instruments	154.9	-	-	-	-	77.5	232.4
Equity shares	-	-	-	26.6	-	-	26.6
Other assets	-	-	95.3	-	-	-	95.3
Total financial assets	**158.1**	**175.0**	**21,368.5**	**2,314.3**	**-**	**77.5**	**24,093.4**
Non-financial assets							**396.7**
Total assets							**24,490.1**
Liabilities							
Deposits by banks	-	-	-	-	1,122.7	-	1,122.7
Customer accounts	-	-	-	-	20,635.0	-	20,635.0
Customer accounts – capital bonds	-	-	-	-	-	-	-
Debt securities in issue	-	-	-	-	627.4	-	627.4
Derivative financial instruments	173.2	-	-	-	-	141.8	315.0
Other borrowed funds	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	34.7	-	34.7
Total financial liabilities	**173.2**	**-**	**-**	**-**	**22,419.8**	**141.8**	**22,734.8**
Non-financial liabilities							**249.7**
Total liabilities							**22,984.5**
Capital and reserves							**1,505.6**
Total liabilities and equity							**24,490.1**

Whilst the Group does not hold any derivative financial instruments that are considered ‘derivatives held for trading purposes’, IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as ‘held for trading’.

Fair value disclosures throughout this note have been calculated in accordance with IFRS 13, which values assets individually, rather than as a portfolio or as part of a business combination.

	Bank						
Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
2017							
Assets							
Cash and balances at central banks	-	-	4,032.1	-	-	-	4,032.1
Loans and advances to banks	-	-	574.8	-	-	-	574.8
Loans and advances to customers	3.2	175.0	16,566.3	-	-	-	16,744.5
Investment securities	-	-	100.0	2,287.7	-	-	2,387.7
Derivative financial instruments	154.9	-	-	-	-	77.5	232.4
Equity shares	-	-	-	26.6	-	-	26.6
Other assets	-	-	95.3	-	-	-	95.3
Total financial assets	158.1	175.0	21,368.5	2,314.3	-	77.5	24,093.4
Non-financial assets							396.7
Total assets							24,490.1
Liabilities							
Deposits by banks	-	-	-	-	1,122.7	-	1,122.7
Customer accounts	-	-	-	-	20,635.1	-	20,635.1
Customer accounts – capital bonds	-	-	-	-	-	-	-
Debt securities in issue	-	-	-	-	627.4	-	627.4
Derivative financial instruments	173.2	-	-	-	-	141.8	315.0
Other borrowed funds	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	34.7	-	34.7
Total financial liabilities	173.2	-	-	-	22,419.9	141.8	22,734.9
Non-financial liabilities							249.7
Total liabilities							22,984.6
Capital and reserves							1,505.5
Total liabilities and equity							24,490.1

Whilst the Bank does not hold any derivative financial instruments that are considered ‘derivatives held for trading purposes’, IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as ‘held for trading’.

Fair value disclosures throughout this note have been calculated in accordance with IFRS 13, which values assets individually, rather than as a portfolio or as part of a business combination.

	Group and Bank						
Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
Re-presented[1] 2016							
Assets							
Cash and balances at central banks	-	-	2,848.2	-	-	-	2,848.2
Loans and advances to banks	-	-	658.3	-	-	-	658.3
Loans and advances to customers	4.1	188.9	19,259.7	-	-	-	19,452.7
Investment securities	-	-	13.8	3,538.1	-	-	3,551.9
Derivative financial instruments	165.7	-	-	-	-	259.8	425.5
Equity shares	-	-	-	46.8	-	-	46.8
Other assets	-	-	96.7	-	-	-	96.7
Total financial assets	169.8	188.9	22,876.7	3,584.9	-	259.8	27,080.1
Non-financial assets							329.6
Total assets							27,409.7
Liabilities							
Deposits by banks	-	-	-	-	1,020.0	-	1,020.0
Customer accounts	-	-	-	-	22,425.1	-	22,425.1
Customer accounts – capital bonds	-	11.8	-	-	-	-	11.8
Debt securities in issue	-	-	-	-	1,625.4	-	1,625.4
Derivative financial instruments	194.6	-	-	-	-	249.9	444.5
Other borrowed funds	-	-	-	-	472.6	-	472.6
Other liabilities	-	-	-	-	45.9	-	45.9
Total financial liabilities	194.6	11.8	-	-	25,589.0	249.9	26,045.3
Non-financial liabilities							405.9
Total liabilities							26,451.2
Capital and reserves							958.5
Total liabilities and equity							27,409.7

1. The comparative figures have been re-presented to more fairly reflect their nature. Further information can be found in notes 13 and 22 to the consolidated financial statements.

a) Use of financial assets and liabilities

The use of financial instruments is essential to the Group's business activities, and financial instruments constitute a significant proportion of the balance sheet. The main financial instruments used, and the purposes for which they are held, are outlined below:

- **Loans and advances to customers and customer accounts**
  The provision of banking facilities to customers is the primary activity of the Group, and loans and advances to customers and customer accounts are major constituents of the balance sheets. Loans and advances to customers include retail mortgages, corporate loans, credit cards, unsecured retail lending and overdrafts. Customer accounts include retail and corporate current and savings accounts.

- **Loans and advances to banks and investment securities**
  Loans and advances to banks and investment securities underpin liquidity requirements and generate incremental net interest income. Held for trading investments are held for economic hedging purposes only as there are no active trading books.

- **Deposits by banks and debt securities in issue**
  Notes secured by mortgage assets have been issued through the Covered Bond programmes.

- **Derivatives**
  A derivative is a financial instrument that derives its value from an underlying rate or price such as interest rates, exchange rates and other market prices. Derivatives are an efficient means of managing market risk and limiting counterparty exposure, and used mainly for hedging purposes and to meet the needs of customers.

  The most frequently used derivative contracts are interest rate swaps, options, caps, floors, currency swaps and forward currency transactions. Terms and conditions are determined by using standard industry documentation. Derivatives are subject to the same market and credit risk control procedures as are applied to other wholesale market instruments and are aggregated with other exposures to monitor total counterparty exposure, which is managed within approved limits for each counterparty.

- **Foreign exchange**
  Foreign exchange dealings are undertaken to facilitate customer requirements and to economically hedge balance sheet exposure to foreign currencies. The risk is managed formally within position limits which are set by the Assets and Liabilities Committee (ALCo), to which authority is delegated by the Board.

b) Valuation of financial assets and liabilities measured at fair value

The carrying values of financial assets and liabilities measured at fair value are determined in compliance with the accounting policies in note 1 to the consolidated financial statements and analysed in the following tables by the three level fair value hierarchy defined as follows:

- Level 1 – Quoted market prices in active markets
- Level 2 – Valuation techniques using observable inputs
- Level 3 – Valuation techniques using unobservable inputs

	Group and Bank			
	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
2017				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	**-**	**3.2**	**-**	**3.2**
Designated at fair value:				
Loans and advances to customers	**-**	**171.2**	**3.8**	**175.0**
Available for sale financial assets:				
Investment securities	**1,462.3**	**1.9**	**823.5**	**2,287.7**
Equity shares	**0.3**	**2.3**	**24.0**	**26.6**
Derivative financial assets	**-**	**232.4**	**-**	**232.4**
Non-financial assets				
Investment properties	**-**	**-**	**2.3**	**2.3**
Total assets carried at fair value	**1,462.6**	**411.0**	**853.6**	**2,727.2**
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	**-**	**-**	**-**	**-**
Derivative financial liabilities	**-**	**315.0**	**-**	**315.0**
Total liabilities carried at fair value	**-**	**315.0**	**-**	**315.0**

	Group and Bank			
	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2016				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	-	4.1	-	4.1
Designated at fair value:				
Loans and advances to customers	-	184.0	4.9	188.9
Available for sale financial assets:				
Investment securities	2,230.7	-	1,307.4	3,538.1
Equity shares	0.2	27.3	19.3	46.8
Derivative financial assets	-	425.5	-	425.5
Non-financial assets				
Investment properties	-	-	2.2	2.2
Total assets carried at fair value	2,230.9	640.9	1,333.8	4,205.6
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	-	11.8	-	11.8
Derivative financial liabilities	-	444.5	-	444.5
Total liabilities carried at fair value	-	456.3	-	456.3

Key considerations in the calculation of fair values for financial assets and liabilities measured at fair value are as follows:

Level 1 – Quoted market prices in active markets
Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

Level 2 – Valuation techniques using observable inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The valuation techniques used to value these instruments employ only observable market data and relate to the following assets and liabilities:

- **Loans and advances to customers**
  Loans and advances to customers primarily relate to corporate loans of £158.1m as at 31 December 2017 (2016: £178.1m), which are fair valued through profit or loss using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

- **Investment securities – available for sale**
  Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

- **Derivative financial instruments**
  Over-the-counter (i.e. non-exchange traded) derivatives are valued using valuation models which are based on observable market data. Valuation models calculate the present value of expected future cash flows, based upon 'no arbitrage' principles. The Group enters into vanilla foreign exchange and interest rate swap derivatives, for which modelling techniques are standard across the industry. Examples of inputs that are generally observable include foreign exchange spot and forward rates, and benchmark interest rate curves.

- **Equity shares**
  Equity shares relate to an investment held in Unity Trust Bank plc, which are unquoted shares. The valuation of these shares is based on an offer to buy back the shares during 2018 by Unity Trust Bank.

Level 3 – Valuation techniques using unobservable inputs
This is used for financial instruments valued using models where one or more significant inputs are not observable.

The proportion of financial assets valued based on significant unobservable inputs are analysed as follows:

- **Loans and advances to customers**
  Loans and advances to customers include 25 year fixed rate mortgages of £3.8m as at 31 December 2017 (2016: £4.9m), which are fair valued through profit or loss using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has decreased the valuation by £0.2m in 2017 (2016: £0.2m increase). A reasonable change in the assumptions would not result in any material change in the valuation.

- **Investment securities – available for sale**
  Investment securities – available for sale include RMBS of £823.5m as at 31 December 2017 (2016: £1,307.4m) which are fair valued through other comprehensive income. An independent third party valuation agent is used to provide prices obtained from large financial institutions. These prices are indicative values only and do not represent an offer to purchase the securities. These RMBS represent the Group's interest in unconsolidated structured entities.

  A 1% increase or decrease in the price of the notes will result in the value increasing or decreasing by approximately £8.2m respectively.

- **Equity shares**
  Equity shares include US Dollar denominated convertible preference shares in Visa International, which are classified as available for sale, with any movements in fair value being recognised through other comprehensive income. The fair value of the Visa International shares has been calculated by taking the period end NYSE share price and discounting for illiquidity and clawback.

  If the illiquidity premium to the discount rate was assumed to be double, it would result in a reduction in the overall fair value of the equity shares of £4.3m as at 31 December 2017 (17.9%).

- **Investment properties**
  Investment properties within level 3 are valued by using recent valuations of individual assets within the portfolio, index linked to the balance sheet date using the relevant house price index.

Movements in fair values of instruments with significant unobservable inputs (level 3) were:

	Group and Bank					
	Fair value at the beginning of the year	**Purchases and transfers in**	**Sales, transfers out and repayments**	**Other comprehensive income**	**Income statement**	**Fair value at the end of the year**
2017						
Loans and advances to customers	**4.9**	**-**	**(0.9)**	**-**	**(0.2)**	**3.8**
Investment securities	**1,307.4**	**4.2**	**(500.8)**	**5.0**	**7.7**	**823.5**
Equity shares	**19.3**	**-**	**-**	**4.7**	**-**	**24.0**
Investment properties	**2.2**	**-**	**-**	**-**	**0.1**	**2.3**
	1,333.8	**4.2**	**(501.7)**	**9.7**	**7.6**	**853.6**
2016						
Loans and advances to customers	5.5	-	(0.8)	-	0.2	4.9
Investment securities	1,599.8	-	(306.5)	9.0	5.1	1,307.4
Equity shares	51.2	16.1	(58.2)	13.5	(3.3)	19.3
Investment properties	2.1	-	(0.1)	-	0.2	2.2
	1,658.6	16.1	(365.6)	22.5	2.2	1,333.8

c) Fair values of financial assets and liabilities not carried at fair value

The carrying values of financial assets and liabilities measured at amortised cost are determined in compliance with the accounting policies in note 1 to the consolidated financial statements and their fair values are analysed in the following tables by the three level fair value hierarchy set out above.

	Group					
		Fair value				
	Total carrying value	Level 1	Level 2	Level 3	Items where fair value approximates carrying value	Total
2017						
Financial assets						
Cash and balances at central banks	**4,032.1**	**-**	**-**	**-**	**4,032.1**	**4,032.1**
Loans and advances to banks	**574.8**	**-**	**9.3**	**-**	**565.0**	**574.3**
Loans and advances to customers	**16,566.3**	**-**	**-**	**14,721.3**	**1,604.0**	**16,325.3**
Investment securities	**100.0**	**-**	**-**	**98.8**	**-**	**98.8**
Other assets	**95.3**	**-**	**-**	**69.5**	**23.7**	**93.2**
Financial liabilities						
Deposits by banks	**1,122.7**	**-**	**1,115.9**	**-**	**3.4**	**1,119.3**
Customer accounts	**20,635.0**	**-**	**-**	**5,452.1**	**15,203.2**	**20,655.3**
Debt securities in issue	**627.4**	**658.2**	**-**	**-**	**-**	**658.2**
Other borrowed funds	**-**	**-**	**-**	**-**	**-**	**-**
Other liabilities	**34.7**	**-**	**-**	**-**	**34.7**	**34.7**

	Bank					
		Fair value				
	Total carrying value	Level 1	Level 2	Level 3	Items where fair value approximates carrying value	Total
2017						
Financial assets						
Cash and balances at central banks	**4,032.1**	**-**	**-**	**-**	**4,032.1**	**4,032.1**
Loans and advances to banks	**574.8**	**-**	**9.3**	**-**	**565.0**	**574.3**
Loans and advances to customers	**16,566.3**	**-**	**-**	**14,721.3**	**1,604.0**	**16,325.3**
Investment securities	**100.0**	**-**	**-**	**98.8**	**-**	**98.8**
Other assets	**95.3**	**-**	**-**	**69.5**	**23.7**	**93.2**
Financial liabilities						
Deposits by banks	**1,122.7**	**-**	**1,115.9**	**-**	**3.4**	**1,119.3**
Customer accounts	**20,635.1**	**-**	**-**	**5,452.1**	**15,203.4**	**20,655.5**
Debt securities in issue	**627.4**	**658.2**	**-**	**-**	**-**	**658.2**
Other borrowed funds	**-**	**-**	**-**	**-**	**-**	**-**
Other liabilities	**34.7**	**-**	**-**	**-**	**34.7**	**34.7**

	Group and Bank					
		Fair value				
	Total carrying value	Level 1	Level 2	Level 3	Items where fair value approximates carrying value	Total
Re-presented[1] 2016						
Financial assets						
Cash and balances at central banks	2,848.2	-	-	-	2,848.2	2,848.2
Loans and advances to banks	658.3	-	9.5	-	648.8	658.3
Loans and advances to customers	19,259.7	-	-	17,381.7	1,366.3	18,748.0
Investment securities	13.8	12.8	-	-	-	12.8
Other assets	96.7	-	-	84.1	12.6	96.7
Financial liabilities						
Deposits by banks	1,020.0	-	990.7	-	29.3	1,020.0
Customer accounts	22,425.1	-	-	6,172.6	16,296.2	22,468.8
Debt securities in issue	1,625.4	1,058.8	663.6	-	-	1,722.4
Other borrowed funds	472.6	-	363.6	-	-	363.6
Other liabilities	45.9	-	-	-	45.9	45.9

1. The comparative figures for loans and advances to banks and deposits by banks have been re-presented to more fairly reflect their nature. Further information can be found in notes 13 and 22 to the consolidated financial statements. The level disclosures have been re-presented to better reflect how the fair value was determined.

Key considerations in the calculation of fair values for loans and receivables and financial liabilities measured at amortised cost are as follows:

Level 1 – Quoted market prices in active markets
Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

Level 2 – Valuation techniques using observable inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The valuation techniques used to value these instruments employ only observable market data and relate to the following assets and liabilities:

- **Loans and advances to banks/deposits by banks**
  Loans and advances to banks include interbank placements and items in the course of collection.

  The amortised cost value of all loans and advances to banks and deposits by banks are deemed to be a close approximation of their fair value due to their short maturity. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.

Level 3 – Valuation techniques using unobservable inputs
This is used for financial instruments valued using models where one or more significant inputs are not observable.

The proportion of financial assets valued based on significant unobservable inputs are analysed as follows:

- **Loans and advances to customers**
  The fair value of loans and advances to customers in total is 98.5% of the carrying value as at 31 December 2017 (2016: 97.3%). The increase in 2017 is largely due to the Warwick Finance Three securitisation during the year, where a large number of the lower-valued Optimum mortgages were sold.

  The overall fair value is less than par primarily due to two main factors:
  - customer interest rates are below the market rate for the period until expected maturity or the repricing date, if earlier
  - credit risk adjustments due to incurred and expected future credit losses

  Fixed rate loans and advances to customers are revalued to fair value based on future interest cash flows (at funding rates) and principal cash flows discounted using an appropriate market rate. The market rate applied in the calculation is the average market rate for new originations of loans with similar characteristics to the book of loans being valued, and reflects the current low interest rate environment. This rate is assumed to encompass the time value of money, plus a risk premium to account for the inherent uncertainty in the timing and amount of future cash flows arising from a book of loan assets.

  Forecast principal repayments are based on redemption at the earlier of maturity or re-pricing date with some overlay for historical behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed that there would be no other factors which market participants would take into account when assessing the fair value of the loan assets. It is assumed that there is no fair value adjustment required in respect of interest rate movement on standard variable rate loan assets, as the interest rate being charged is assumed to be equal to the market rate for those loan assets.

  Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available.

- **Investment securities – loans and receivables**
  Investment securities – loans and receivables include:
  - RMBS measured at amortised cost of £87.0m as at 31 December 2017 (2016: £nil), being a 5% regulatory holding of the Warwick Finance Three unconsolidated structured entity. The remaining 95% is privately held therefore there are no available market prices. An in-house model is used that sources independent market data for disclosure purposes only.
  - Securities measured at amortised cost of £13.0m as at 31 December 2017 (2016: £13.8m) that moved from Level 1 to Level 3 due to the quoted price being in an inactive market.

- **Other assets**
  Other assets include the surrendered loss debtor with an amortised cost of £71.6m as at 31 December 2017 (2016: £84.1m). The fair value of the surrendered loss debtor as at 31 December 2017 is estimated using unobservable inputs to be £69.5m. The fair value as at 31 December 2017 was determined by discounting the expected cash flows under the terms of the agreement with Co-operative Group. Cash flows are discounted at a discount rate reflecting the yield of the longest maturity Co-operative Group bond in issue (adjusted to reflect the weighted average maturity of cash flows due from Co-operative Group), plus a premium to estimate the uncertainties associated with the matters set out in note 2.7 to the consolidated financial statements. The premium is calculated applying risk parameter estimation theory using observable inputs from related (but not identical) financial instruments or indices. The fair value as at 31 December 2016 has been included in level 3, but was determined to approximate to amortised cost.

- **Customer accounts**
  The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on future interest cash flows (at funding rates) and principal cash flows, discounted using an appropriate market rate.

d) Unwind of merger fair value adjustments
On the merger of the Bank and Britannia Building Society in August 2009 an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments have been unwinding mainly on an EIR basis over the expected lives of the assets and liabilities. As at 31 December 2017, the remaining merger fair value unwinds were no longer considered to be material primarily due to the redemption of the Leek Finance Number Nineteen plc debt securities in issue, on 21 June 2017. As such, the remaining merger fair value adjustments were written off to provide better clarity and relevance within the accounts.

The net asset balance of £1.8m was written off to the income statement within operating expenses (other administrative expenses), with the balances at the time split across the following balance sheet categories:
- loans and advances to customers (£3.9m credit; comprising £7.2m credit to gross loans and advances, £3.3m debit to allowance for losses);
- fair value adjustments for hedged risk (£2.2m credit);
- non-current assets classified as held for sale (£0.6m debit);
- property, plant and equipment (£0.7m debit); and
- intangible assets (£6.6m debit).

e) Fair value of transferred assets and associated liabilities
Securitisation vehicles
When the sale of the loans and advances to customers to certain securitisation vehicles fails to meet the derecognition criteria, then these loans remain on the balance sheet. Therefore a deemed loan financial liability is recognised on the balance sheet and an equivalent deemed loan asset is held on each securitisation company's balance sheet. The deemed loans are repaid as and when principal repayments are made by customers against these transferred loans and advances, and when the securitisation's unwind.

The securitisation vehicles have issued floating rate notes which are secured on the loans and advances to customers. Prior to the call dates, the notes are redeemable in part, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets.

Substantially all of the risks and rewards of ownership are retained. The Group benefits to the extent to which surplus income generated by the transferred mortgage portfolios exceeds the administration costs of those mortgages, whilst continuing to bear the credit risk of these mortgage assets, on account of holding subordinated notes issued by the securitisation vehicles.

Leek Finance Number Nineteen plc was called on 21 June 2017 and therefore there are no balances remaining relating to this entity.

In 2017, £1.4bn of mortgages was sold beneficially to Silk Road Finance Number Four plc. The issued notes from the securitisation were all retained and therefore are not shown in the consolidated balance sheet.

Covered Bond Limited Liability Partnerships
Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the £1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. At the year end the Group held a loan of £0.6bn (2016: £0.6bn) and a capital contribution of £0.6bn (2016: £0.6bn) with Moorland Covered Bonds LLP.

Moorland Covered Bonds LLP does not have ordinary share capital. The Group's interest in Moorland Covered Bonds LLP is in substance no different from a wholly owned subsidiary and consequently it is fully consolidated. The table below shows the carrying values and fair values of the assets transferred to the covered bond and their associated liabilities:

	Group and Bank				
	Carrying amount of transferred loans and advances to customers	**Carrying amount of fixed and floating rate notes**	**Fair value of transferred loans and advances to customers**	**Fair value of fixed and floating rate notes**	**Net fair value position**
2017					
Moorland Covered Bonds LLP	**1,184.2**	**597.9**	**1,173.8**	**654.9**	**518.9**
2016					
Moorland Covered Bonds LLP	1,208.5	597.4	1,188.9	669.8	519.1

Assets pledged
Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Group's day-to-day operations.

	Group and Bank				
	Carrying amount of assets not derecognised	**Carrying amount of associated liabilities**	**Fair value of assets not derecognised**	**Fair value of associated liabilities**	**Net fair value position**
2017					
Investments securities sold under repurchase agreements	**1,206.3**	**920.4**	**1,206.3**	**920.4**	**285.9**
Re-presented[1] 2016					
Investments securities sold under repurchase agreements	1,260.1	990.6	1,260.1	990.6	269.5

1. The comparative figures have been re-presented to more fairly reflect their nature. Further information can be found in notes 13 and 22 to the consolidated financial statements.

Associated liabilities are included within deposits by banks.

Assets sold under repurchase agreements include mortgage backed securities (£386.2m of assets and associated liabilities of £100.1m) and UK government gilts (£820.1m of assets and associated liabilities of £820.3m).

35. Interests in unconsolidated structured entities

The table below shows only the continuing involvement retained in three unconsolidated SPEs, being rated Notes issued by Warwick Finance One, Two and Three and a residual interest in Warwick Finance Three. These notes are reported as Investment Securities - Available for Sale. The maximum exposure to loss is the carrying value of these instruments.

	Group and Bank				
	Carrying amount of continuing involvement in statement of financial position		Fair value of continuing involvement		Maximum exposure to loss
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	£m
31 December 2017	**910.5**	**-**	**910.5**	**-**	**910.5**

	Group and Bank				
	Carrying amount of continuing involvement in statement of financial position		Fair value of continuing involvement		Maximum exposure to loss
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	£m
31 December 2016	1,307.4	-	1,307.4	-	1,307.4

	Group and Bank				
	Gain or loss recognised at transfer date £m	Gain or loss recognised on sale £m	Interest income/(expense) recognised in the year £m	FV movement recognised in OCI £m	Income/(expense) recognised cumulatively £m
31 December 2017	**-**	**4.8**	**17.9**	**5.0**	**22.7**

	Group and Bank				
	Gain or loss recognised at transfer date £m	Gain or loss recognised on sale £m	Interest income/(expense) recognised in the year £m	FV movement recognised in OCI £m	Income/(expense) recognised cumulatively £m
31 December 2016	-	0.5	31.4	9.0	31.9

The assets in the table above represent the continuing involvement in securitisations where assets are transferred to an unconsolidated SPE, but some of the notes issued by the SPE are retained. These notes are reported in Investment securities - available for sale. The maximum exposure to loss is the carrying amount of the notes.

There is also a requirement to fund any Conduct Redress for the mortgages. Currently funded is £4.1m however anything above/below this figure will be due from/back to the Group.

36. Events after the balance sheet date

On 12 January 2018 the Group announced proposals to colleagues to close 27 branches across England and Wales by 1 June 2018 in response to a continued change in how customers choose to bank. In the past year a significant number of customers have switched to digital banking, following significant investment and improvements in the Group's digital channels as part of its transformation. In the same period, transactions carried out in branch have decreased. The proposed changes would mean the Group's network will comprise 68 branches in total.

The Group has spoken to affected colleagues and is consulting with colleagues and trade unions on the proposals. The Group is seeking to keep job losses to a minimum and will look to redeploy colleagues into posts within the Group where possible. This does not impact the 2017 financial statements.

The Bank has undertaken a £960.0m drawing of the Bank of England's Term Funding Scheme in February 2018. The Bank is obliged to repay this borrowing by February 2022.

The Bank Company balance sheet
As at 31 December 2017

All amounts are stated in £m unless otherwise indicated

	Note	**2017**	Re-presented[1] 2016
Assets			
Cash and balances at central banks	2	**4,032.0**	2,848.2
Loans and advances to banks	3	**460.3**	440.5
Loans and advances to customers	4	**16,608.2**	19,293.4
Fair value adjustments for hedged risk		**70.3**	131.6
Investment securities - loans and receivables	5a	**1,450.0**	34.8
Investment securities - available for sale	5b	**2,287.7**	3,538.1
Derivative financial instruments	6	**197.4**	261.2
Property, plant and equipment classified as held for sale		**2.8**	5.3
Equity shares	7	**24.3**	44.8
Investments in subsidiaries/Group undertakings	21	**51.6**	806.8
Investment properties		**2.3**	2.2
Property, plant and equipment	9	**44.4**	31.8
Intangible assets	8	**81.5**	100.1
Amounts owed by other Co-operative Bank undertakings	22	**1,322.2**	1,106.3
Other assets	10	**79.3**	148.9
Prepayments and accrued income	11	**24.6**	28.7
Current tax assets		**2.5**	-
Deferred tax assets	18	**0.6**	1.6
Net retirement benefit asset	19	**157.7**	20.3
Total assets		**26,899.7**	28,844.6

	Note	**2017**	Re-presented[1] 2016
Liabilities			
Deposits by banks	12	**1,122.7**	1,020.0
Customer accounts		**20,635.7**	22,558.5
Customer accounts - capital bonds		**-**	11.8
Debt securities in issue	13	**600.7**	1,006.8
Derivative financial instruments	6	**308.8**	495.8
Other borrowed funds	14	**-**	472.6
Amounts owed to other Co-operative Bank undertakings	22	**2,505.7**	2,141.0
Other liabilities	15	**33.9**	44.9
Accruals and deferred income	16	**59.9**	91.3
Provisions for liabilities and charges	17	**157.4**	275.5
Net retirement benefit liability	19	**11.3**	-
Total liabilities		**25,436.1**	28,118.2

	Note	**2017**	Re-presented[1] 2016
Capital and reserves attributable to the Bank Company's equity holders			
Ordinary share capital	23	**25.6**	22.6
Share premium account	23	**2,416.9**	1,736.9
Retained earnings		**(1,514.4)**	(1,547.2)
Available for sale reserve		**24.8**	38.2
Capital redemption reserve		**410.0**	410.0
Cash flow hedging reserve		**29.9**	56.4
Defined benefit pension reserve		**70.8**	9.5
Total equity		**1,463.6**	726.4
Total liabilities and equity		**26,899.7**	28,844.6

1. The comparative figures have been re-presented to more fairly reflect their nature. Further information can be found in notes 3 and 12 to the Bank company financial statements.

Net profit/(loss) attributable to equity shareholders was £32.8m (2016:loss £529.4m).

The notes on pages 180 to 202 form part of these financial statements.

Approved by the Board for The Co-operative Bank Plc 13 March 2018:

Dennis Holt	Liam Coleman	Tom Wood
Chairman	Chief Executive Officer	Chief Financial and Restructuring Officer

The Bank Company statement of cash flows
For the year ended 31 December 2017
All amounts are stated in £m unless otherwise indicated

	2017	Re-presented[1] 2016
Cash flows from operating activities:		
Profit/(loss) before taxation	**41.2**	(556.1)
Adjustments for:		
Gain on capital raise	**(7.4)**	-
Gain on pension scheme modification	**(51.9)**	-
Interest payable in respect of other borrowed funds	**25.4**	43.9
Effect of exchange rate movements	**(5.2)**	(10.9)
Fair value of movements on investment properties	**(0.1)**	(0.2)
Loss on loans and advances	**1.3**	41.9
Fair value movement on loans and advances	**6.4**	8.1
Depreciation and amortisation	**35.4**	40.9
Interest amortisation	**5.2**	(13.6)
Fair value movements and amortisation of financial assets and liabilities	**34.7**	(82.1)
Profit on disposal of investment securities	**(6.3)**	(18.4)
Gain on sale of equity shares	**(22.8)**	(58.1)
Impairment of property, plant and equipment	**0.5**	1.0
Impairment of intangible fixed assets	**3.1**	40.6
Gain on disposal of property, plant, equipment and software	**(0.1)**	(4.8)
Loss on sale of loans and advances to customers	**11.5**	7.2
Net impairment of investment in subsidiaries	**167.3**	538.9
Dividends received	**(262.1)**	(320.9)
Unwind of fair value adjustments arising on transfer of engagements	**1.7**	-
	(22.2)	(342.6)
Increase in deposits by banks	**102.7**	304.1
Decrease in prepayments and accrued income	**4.1**	14.8
Decrease in accruals and deferred income	**(31.4)**	(34.9)
Decrease in customer accounts and capital bonds	**(1,934.6)**	(642.4)
(Decrease)/increase in debt securities in issue	**(406.1)**	1.1
Decrease in loans and advances to banks	**3.5**	4.4
Decrease/(increase) in loans and advances to customers	**2,654.3**	(6,858.7)
(Increase)/decrease in amounts owed by Co-operative Bank undertakings	**(215.9)**	7,216.5
Increase/(decrease) in amounts owed to Co-operative Bank undertakings	**364.7**	(1,045.4)
Net movement of other assets and other liabilities	**(163.5)**	(30.9)
Income tax/group relief received	**71.6**	0.4
Net cash flows from/(used in) operating activities	**427.2**	(1,413.6)
Cash flows from investing activities:		
Purchase of tangible and intangible fixed assets	**(43.1)**	(40.3)
Proceeds from sale of property, plant and equipment	**4.9**	16.3
Purchase of investment securities	**(1,859.9)**	(363.7)
Proceeds from sale of equity shares	**25.3**	41.8
Proceeds from sale and maturity of investment securities	**1,651.6**	1,784.7
Net movement on investments in Co-operative Bank undertakings	**587.9**	(131.3)
Dividends received	**262.1**	320.9
Net cash flows from investing activities	**628.8**	1,628.4
Cash flows from/(used in) financing activities:		
Interest paid on other borrowed funds	**(29.3)**	(43.9)
Net cash raised through Restructuring and Recapitalisation	**180.4**	-
Net cash flows from/(used in) financing activities	**151.1**	(43.9)

	Note	2017	Re-presented[1] 2016
Net increase in cash and cash equivalents		**1,207.1**	170.9
Cash and cash equivalents at the beginning of the financial year		**3,247.6**	3,076.7
Cash and cash equivalents at the end of the financial year		**4,454.7**	3,247.6
Cash and balances with central banks	2	**3,994.4**	2,807.2
Loans and advances to banks	3	**460.3**	440.4
		4,454.7	3,247.6

Reconciliation of movements of liabilities to cash flows arising from financing activities

	Deposits by banks	Customer accounts	Customer accounts – capital bonds	Debt securities in issue	Derivative financial instrument liabilities	Other borrowed funds
Balance at 1 January 2017 re-presented[1]	**1,020.0**	**22,558.5**	**11.8**	**1,006.8**	**495.8**	**472.6**
Changes from financing cash flows						
Interest paid on other borrowed funds	-	-	-	-	-	**(29.3)**
Total changes from financing cash flows	**-**	**-**	**-**	**-**	**-**	**(29.3)**
Other changes						
Movement in deposits by banks	**102.7**	**-**	**-**	**-**	**-**	**-**
Movement in debt securities in issue	**-**	**-**	**-**	**(406.1)**	**-**	**-**
Net movement in other liabilities	**-**	**(1,922.7)**	**(11.8)**	**-**	**(187.0)**	**-**
Debt restructuring as part of capital raise	**-**	**-**	**-**	**-**	**-**	**(468.7)**
Interest payable on other borrowed funds	**-**	**-**	**-**	**-**	**-**	**25.4**
Balance at 31 December 2017	**1,122.7**	**20,635.8**	**-**	**600.7**	**308.8**	**-**

1. The comparative figures have been re-presented in order to separately analyse the gain on sale of equity shares to more fairly reflect the nature of the balances, and the obligatory netting arrangements in place relating to repo and reverse repo transactions. Further information on the netting arrangements can be found in notes 3 and 12 to the Bank Company financial statements.

The notes on pages 180 to 202 form part of these financial statements.

The Bank Company statement of changes in equity
For the year ended 31 December 2017
All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Bank Company							
	Share capital	**Share premium**	**Available for sale reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Defined benefit pension scheme**	**Retained earnings**	**Total equity**
2017								
Balance at the beginning of the year	**22.6**	**1,736.9**	**38.2**	**56.4**	**410.0**	**9.5**	**(1,547.2)**	**726.4**
Total comprehensive (expense)/income for the year	**-**	**-**	**(13.4)**	**(26.5)**	**-**	**61.3**	**32.8**	**54.2**
Issuance of new share capital	**3.0**	**680.0**	**-**	**-**	**-**	**-**	**-**	**683.0**
Balance at the end of the year	**25.6**	**2,416.9**	**24.8**	**29.9**	**410.0**	**70.8**	**(1,514.4)**	**1,463.6**

	Attributable to equity holders of the Bank Company							
	Share capital	Share premium	Available for sale reserve	Cash flow hedging reserve	Capital redemption reserve	Defined benefit pension scheme	Retained earnings	Total equity
2016								
Balance at the beginning of the year	22.6	1,736.9	55.6	34.6	410.0	-	(1,017.8)	1,241.9
Total comprehensive (expense)/income for the period	-	-	(17.4)	21.8	-	9.5	(529.4)	(515.5)
Balance at the end of the year	22.6	1,736.9	38.2	56.4	410.0	9.5	(1,547.2)	726.4

The notes on pages 180 to 202 form part of these financial statements.

NOTES TO THE BANK COMPANY FINANCIAL STATEMENTS

1. Net profit/(loss) attributable to equity shareholders of the Bank Company

On including the Bank Company financial statements here together with the consolidated Bank financial statements, the Bank Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these financial statements.

	2017	2016
Net profit/(loss) attributable to equity shareholders of the Bank Company	**32.8**	(529.4)

2. Cash and balances at central banks

	2017	2016
Cash in hand	**48.9**	50.5
Items in transit	**(35.9)**	-
Balances with the Bank of England other than mandatory reserve deposits	**3,981.4**	2,756.7
Included in cash and cash equivalents	**3,994.4**	2,807.2
Mandatory reserve deposits with the Bank of England	**37.6**	41.0
	4,032.0	2,848.2

Mandatory reserve deposits are not available for use in the day-to-day operations, are non-interest bearing and are not included in cash and cash equivalents.

Items in transit represent unpresented cheques, which were reclassified from deposits by banks and other liabilities in order to more fairly reflect their nature.

3. Loans and advances to banks

	2017	Re-presented[1] 2016
Items in course of collection from other banks	**12.8**	9.6
Placements with other banks	**447.5**	430.8
Included in cash and cash equivalents	**460.3**	440.4
Other loans and advances to banks	**-**	0.1
	460.3	440.5

1. Following a review of our documentation, obligatory netting arrangements were found to be in place for repo and reverse repo transactions. As a result the amount reduced by netting is £300.0m (2016 Re-presented: £178.6m), with the opposing impact in Deposits by banks in note 12 to the Bank Company financial statements.

4. Loans and advances to customers

	2017	2016
Gross loans and advances	**16,687.1**	19,421.7
Less: allowance for losses	**(78.9)**	(128.3)
	16,608.2	19,293.4

Loans and advances to customers include £175.0m (2016: £188.9m) of financial assets at fair value through profit or loss designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency, and £3.2m (2016: £4.1m) of financial assets held for trading. Of these, £80.2m (2016: £118.5m) are secured by real estate collateral.

Loans and advances to customers include £2.5bn (2016: £1.8bn) of loans pledged under the Bank Company's securitisation and covered bond activities. The Bank Company remains exposed to substantially all of the risks and rewards of ownership of these assets. Secured on these mortgage assets are £nil (2016: £nil) deposits by banks and £0.6bn (2016: £1.1bn) of fixed and floating rate notes.

Concentration of exposure

The Bank Company's exposure is predominantly within the UK. Further information on the concentration of exposure is included within the risk management disclosures.

Allowance for losses on loans and advances:

	Retail		BaCB		Legacy Portfolio		Optimum		
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective	Total
2017									
At the beginning of the year	**-**	**64.5**	**0.5**	**0.5**	**46.2**	**1.3**	**-**	**15.3**	**128.3**
Transfer into Bank Company	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Reclassification between collective and individual	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Charge/(release) against profits	**-**	**10.6**	**-**	**(0.2)**	**(2.4)**	**0.3**	**-**	**(8.7)**	**(0.4)**
Amounts written off	**-**	**(30.8)**	**(0.1)**	**-**	**(15.1)**	**-**	**-**	**(2.9)**	**(48.9)**
Unwind of discount allowance	**-**	**-**	**-**	**-**	**(0.1)**	**-**	**-**	**-**	**(0.1)**
Transfer between business units	**-**	**(3.2)**	**-**	**-**	**-**	**-**	**-**	**3.2**	**-**
At the end of the year	**-**	**41.1**	**0.4**	**0.3**	**28.6**	**1.6**	**-**	**6.9**	**78.9**

	Retail		BaCB		Legacy Portfolio		Optimum		
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective	Total
2016									
At the beginning of the year	2.1	101.5	1.0	0.8	116.0	7.3	-	-	228.7
Transfer into Bank Company	-	3.1	-	-	-	-	-	17.3	20.4
Reclassification between collective and individual	(2.1)	2.1	-	-	-	-	-	-	-
Charge/(release) against profits	-	2.2	-	(0.3)	23.0	(6.0)	-	(0.4)	18.5
Amounts written off	-	(44.4)	(0.5)	-	(91.6)	-	-	(1.6)	(138.1)
Unwind of discount allowance	-	-	-	-	(1.2)	-	-	-	(1.2)
At the end of the year	-	64.5	0.5	0.5	46.2	1.3	-	15.3	128.3

Loans and advances to customers including finance lease receivables:

	2017	2016
Gross investment in finance leases may be analysed as follows:		
No later than one year	**1.8**	2.2
Later than one year and no later than five years	**6.8**	7.0
Later than five years	**11.4**	13.3
	20.0	22.5
Unearned future finance income on finance leases	**(6.2)**	(7.3)
Net investment in finance leases	**13.8**	15.2

The net investment in finance leases may be analysed as follows:		
No later than one year	**1.1**	1.4
Later than one year and no later than five years	**4.3**	4.2
Later than five years	**8.4**	9.6
	13.8	15.2

There are no unguaranteed residual values for any of the finance leases. The Bank Company has finance lease arrangements with customers in a wide range of sectors including transport, retail and utilities.

5. Investment securities
a) Loans and receivables

	2017	2016
Loans and receivables:		
Listed	**1,450.0**	34.8
Total gross investment securities - loans and receivables	**1,450.0**	34.8
Less: allowance for losses	**-**	-
Total net investment securities - loans and receivables	**1,450.0**	34.8

Movement in investment securities - loans and receivables

	2017	2016
At the beginning of the year	**34.8**	66.1
Acquisitions	**1,538.6**	-
Disposals and maturities	**(124.5)**	(38.3)
Exchange adjustments	**(0.1)**	2.7
Movement in interest accrual	**0.6**	4.3
Amortisation	**0.6**	-
At the end of the year	**1,450.0**	34.8

b) Available for sale

	2017	2016
Available for sale:		
Listed	**2,287.7**	3,538.1
Total gross investment securities available for sale	**2,287.7**	3,538.1
Less: allowance for losses	**-**	-
Total net investment securities available for sale	**2,287.7**	3,538.1

Movement in investment securities - available for sale

	2017	2016
At the beginning of the year	**3,538.1**	4,296.8
Acquisitions	**321.3**	363.7
Disposals and maturities	**(1,520.8)**	(1,161.5)
Fair value movements through equity	**(0.5)**	12.7
Fair value through profit or loss	**(48.5)**	32.2
Amortisation	**2.6**	(1.5)
Movement in interest accrual	**(6.2)**	(4.3)
Write back of previously written off assets	**1.7**	-
At the end of the year	**2,287.7**	3,538.1

c) Analysis of investment securities by issuer

	2017	2016
Investment securities issued by public bodies:		
Government securities	**1,113.0**	1,661.5
Other public sector securities	**223.8**	173.7
Total investment securities issued by public bodies	**1,336.8**	1,835.2
Other debt securities:		
Other floating rate notes	**127.4**	395.5
Mortgage backed securities	**2,273.5**	1,342.2
Total investment securities issued by other issuers	**2,400.9**	1,737.7
Total investment securities	**3,737.7**	3,572.9

Other floating rate notes (FRNs) relate to Sterling denominated FRNs with contractual maturities ranging from six months to seven years from the balance sheet date.

6. Derivative financial instruments

The Bank Company has entered, as principal, into various derivatives either as economic hedges which are treated as held for trading (not in a qualifying hedge relationship), or in a qualifying hedge accounting relationship for the management of interest rate risk and foreign exchange rate risk. Positive and negative fair values have not been netted off as the Bank Company does not have a legal right of offset.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Bank Company and the Bank. Derivatives used to manage interest rate related positions include swaps, caps and floors, forward rate agreements and exchange traded futures. The foreign exchange rate positions are managed using forward currency transactions and swaps. Equity risk is managed using equity swaps.

During the year the Bank Company has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

	2017 Fair value		2016 Fair value	
	Assets	**Liabilities**	Assets	Liabilities
Derivatives held for non-trading purposes				
Derivatives designated as cash flow hedges:				
Interest rate swaps	**44.7**	**(4.9)**	72.1	(3.6)
Derivatives designated as fair value hedges:				
Interest rate swaps	**4.8**	**(136.9)**	23.4	(246.3)
Cross currency interest rate swaps	**-**	**-**	-	-
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**147.4**	**(166.6)**	162.4	(182.9)
Cross currency interest rate swaps	**-**	**-**	-	(0.5)
Forward currency transactions	**0.5**	**(0.4)**	0.4	(0.6)
OTC interest rate options	**-**	**-**	0.3	(0.3)
Equity swaps	**-**	**-**	2.6	-
Credit default swaps with subsidiary undertakings	**-**	**-**	-	(61.6)
Total derivative assets/(liabilities) held for non-trading purposes	**197.4**	**(308.8)**	261.2	(495.8)
Total recognised derivative assets/(liabilities)	**197.4**	**(308.8)**	261.2	(495.8)

7. Equity shares

	2017 £m	2016 £m
Investment securities:		
Listed	**0.3**	0.2
Unlisted	**24.0**	44.6
	24.3	44.8
Included above are the following unlisted trade investments:		
Visa International - (38,847 Series B Preference Shares) (2016: 38,847)	**24.0**	19.3
VocaLink Holdings Limited -(nil ordinary shares of £1 each) (2016: 4,416,165)	**-**	25.3

Equity shares are classified as available for sale. The fair value of Visa International preference shares has been remeasured based on the equity price of Visa International shares, discounted for the estimated amount of preference shares to be clawed back and an illiquidity discount. The valuation technique used to calculate the fair value of equity shares is set out in note 24 to the Bank Company financial statements. In 2017, the Bank Company sold its shares in VocaLink Holdings Limited.

8. Intangible assets

	2017			2016		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other Intangible assets	Total
Cost						
At the beginning of the year	**162.8**	**41.8**	**204.6**	241.9	46.0	287.9
Additions	**18.0**	**4.3**	**22.3**	26.5	-	26.5
Disposals	**-**	**-**	**-**	(65.0)	(4.2)	(69.2)
Impairment	**(3.1)**	**-**	**(3.1)**	(40.6)	-	(40.6)
Merger fair value write off[1]	**-**	**(41.8)**	**(41.8)**	-	-	-
Write off of fully amortised assets	**(3.1)**	**-**	**(3.1)**	-	-	-
Transfer between categories[2]	**(11.0)**	**11.0**	**-**	-	-	-
At the end of the year	**163.6**	**15.3**	**178.9**	162.8	41.8	204.6
Accumulated amortisation and impairment						
At the beginning of the year	**73.5**	**31.0**	**104.5**	114.1	31.0	145.1
Charge for the year	**24.3**	**6.9**	**31.2**	24.9	4.2	29.1
Disposals	**-**	**-**	**-**	(65.5)	(4.2)	(69.7)
Merger fair value write off[1]	**-**	**(35.2)**	**(35.2)**	-	-	-
Write off of fully amortised assets	**(3.1)**	**-**	**(3.1)**	-	-	-
Transfer between categories[2]	**(4.0)**	**4.0**	**-**	-	-	-
At the end of the year	**90.7**	**6.7**	**97.4**	73.5	31.0	104.5
Net book value						
At the end of the year	**72.9**	**8.6**	**81.5**	89.3	10.8	100.1
At the beginning of the year	**89.3**	**10.8**	**100.1**	127.8	15.0	142.8

1. The remaining Britannia merger fair value has been written off in 2017. Refer to note 34 to the consolidated financial statements - Fair values of financial assets and liabilities for further information.
2. This relates to a reclassification of assets classified as internally generated, which were externally generated.

Internally generated assets include £18.1m (2016: £17.1m) of assets in the course of construction.

Other intangible assets wholly consist of purchased software licences.

9. Property, plant and equipment

2017	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost					
At the beginning of the year	**14.5**	**-**	**35.6**	**9.3**	**59.4**
Additions	**3.5**	**-**	**0.2**	**17.1**	**20.8**
Disposals	**-**	**-**	**-**	**-**	**-**
Impairment	**-**	**-**	**-**	**(0.5)**	**(0.5)**
Merger fair value write off[1]	**(1.1)**	**-**	**-**	**-**	**(1.1)**
Write off of fully depreciated assets	**-**	**-**	**(2.8)**	**-**	**(2.8)**
Classified as held for sale	**(3.5)**	**-**	**-**	**-**	**(3.5)**
Transfer between categories	**(1.2)**	**14.6**	**7.7**	**(21.1)**	**-**
At the end of the year	**12.2**	**14.6**	**40.7**	**4.8**	**72.3**
Accumulated depreciation					
At the beginning of the year	**4.1**	**-**	**23.5**	**-**	**27.6**
Charge for the year	**0.5**	**-**	**3.7**	**-**	**4.2**
Disposals	**-**	**-**	**-**	**-**	**-**
Merger fair value write off	**(0.4)**	**-**	**-**	**-**	**(0.4)**
Write off of fully depreciated assets	**-**	**-**	**(2.8)**	**-**	**(2.8)**
Classified as held for sale	**(0.7)**	**-**	**-**	**-**	**(0.7)**
Transfer between categories	**(1.2)**	**-**	**1.2**	**-**	**-**
At the end of the year	**2.3**	**-**	**25.6**	**-**	**27.9**
Net book value					
At the end of the year	**9.9**	**14.6**	**15.1**	**4.8**	**44.4**
At the beginning of the year	**10.4**	**-**	**12.1**	**9.3**	**31.8**

1. The remaining Britannia merger fair value has been written off in 2017. Refer to note 34 to the consolidated financial statements - Fair values of financial assets and liabilities for further information.

2016	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost					
At the beginning of the year	23.2	23.7	100.6	2.3	149.8
Additions	2.7	-	3.1	8.0	13.8
Disposals	(5.2)	(23.7)	(68.1)	-	(97.0)
Classified as held for sale	(6.2)	-	-	-	(6.2)
Impairment	-	-	-	(1.0)	(1.0)
At the end of the year	14.5	-	35.6	9.3	59.4
Accumulated depreciation					
At the beginning of the year	4.7	23.6	79.3	-	107.6
Charge for the year	4.1	-	7.7	-	11.8
Disposals	(2.7)	(23.6)	(63.5)	-	(89.8)
Classified as held for sale	(2.0)	-	-	-	(2.0)
At the end of the year	4.1	-	23.5	-	27.6
Net book value					
At the end of the year	10.4	-	12.1	9.3	31.8
At the beginning of the year	18.5	0.1	21.3	2.3	42.2

10. Other assets

	2017	2016
Amounts recoverable within one year:		
Other assets	**19.9**	80.7
Amounts owed by Co-operative Group	**-**	10.2
Deferred consideration receivable	**-**	0.3
Amounts recoverable after more than one year:		
Amounts owed by Co-operative Group	**55.0**	53.7
Deferred consideration receivable	**4.4**	4.0
	79.3	148.9

Amounts owed by Co-operative Group represents surrendered loss debtor of £55.0m (2016 Restated: £61.1m).

11. Prepayments and accrued income

	2017	2016
Amounts recoverable within one year	**24.0**	24.1
Amounts recoverable after more than one year	**0.6**	4.6
	24.6	28.7

12. Deposits by banks

	2017	Re-presented[1] 2016
Items in course of collection	**-**	20.5
Deposits from other banks	**1,122.7**	999.5
	1,122.7	1,020.0

1. Following a review of our documentation, obligatory netting arrangements were found to be in place for repo and reverse repo transactions. As a result the amount reduced by netting is £300.0m (2016 Re-presented: £178.6m), with the opposing impact in Loans and advances to banks in note 3 to the Bank Company financial statements.

Included within deposits from other banks are liabilities of £1,120.5m (2016 Re-presented: £990.6m) secured on investment securities with a carrying value of £1,206.3m (2016: £1,260.1m) which have been sold under sale and repurchase agreements (note 24 to the Bank Company financial statements). Items in course of collection is £nil in 2017 as the unpresented cheques have been reclassified to Cash in order to more fairly reflect their nature.

13. Debt securities in issue

The Bank Company has entered into cross currency interest rate swaps that protect it from changes in exchange rates and interest rates on its debt securities in issue. Where appropriate, the Bank Company applies fair value hedge accounting to reduce the accounting volatility from these positions.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. Some of these notes (securitisations) are redeemable in part, being limited to the net capital received from mortgagors in respect of the underlying assets and payments made when the securitisations unwind. There is no obligation for the Bank Company to make good any shortfall out of general funds. Other notes (covered bonds secured and certificates of deposit) require the Bank Company to repay contractual amounts due on specified maturity dates.

14. Other borrowed funds

The Restructuring and Recapitalisation resulted in the completion of a debt for equity swap. As such, the subordinated notes were extinguished. This is discussed in further detail in note 2.1 to the consolidated financial statements.

15. Other liabilities

	2017	2016
Amounts falling due within one year:		
ATM creditor	**3.1**	4.6
Other creditors	**26.3**	31.4
Amounts falling due after one year:		
Other creditors	**4.5**	8.9
	33.9	44.9

Other creditors of the Bank Company include finance lease obligations as follows:

	Present value of lease payments		Future minimum lease payments	
	2017	2016	**2017**	2016
Due within one year	**-**	-	**-**	-
Due between one year and five years	**0.1**	0.1	**0.1**	0.1
Due after five years	**1.2**	1.3	**1.4**	1.5
	1.3	1.4	**1.5**	1.6

The future minimum lease payments have been discounted at LIBOR (London Interbank Offered Rate) over the term of the lease to give the present value of these payments.

16. Accruals and deferred income

	2017	2016
Amounts falling due within one year	**49.9**	80.3
Amounts falling due after one year	**10.0**	11.0
	59.9	91.3

17. Provisions for liabilities and charges

2017	**Property**	**FSCS levies**	**PPI**	**Conduct/ legal**	**Separation**	**Other**	**Total**
At the beginning of the year	**32.0**	**6.6**	**90.4**	**79.1**	**27.3**	**40.1**	**275.5**
Provided/(released) in the year:							
Interest income	**-**	**-**	**-**	**0.4**	**-**	**-**	**0.4**
Operating expense	**(0.3)**	**-**	**-**	**1.0**	**(4.0)**	**19.9**	**16.6**
Provision for customer redress	**-**	**-**	**38.5**	**(11.5)**	**-**	**-**	**27.0**
Utilised during the year	**(10.8)**	**(4.2)**	**(40.0)**	**(36.1)**	**(23.3)**	**(47.7)**	**(162.1)**
Transferred from Group undertakings	**-**	**-**	**-**	**-**	**-**	**-**	**-**
At the end of the year	**20.9**	**2.4**	**88.9**	**32.9**	**-**	**12.3**	**157.4**
Provisions were analysed as follows:							
Amounts falling due within one year	**12.3**	**2.4**	**50.0**	**29.2**	**-**	**11.9**	**105.8**
Amounts falling due after one year	**8.6**	**-**	**38.9**	**3.7**	**-**	**0.4**	**51.6**
Total provisions	**20.9**	**2.4**	**88.9**	**32.9**	**-**	**12.3**	**157.4**

2016	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year	42.7	10.8	87.0	229.3	64.3	24.4	458.5
Provided/(released) in the year:							
Interest income	-	-	-	2.3	-	-	2.3
Operating expense	1.0	4.9	-	(1.0)	16.2	37.5	58.6
Provision for customer redress	-	-	36.0	(11.3)	-	-	24.7
Utilised during the year	(11.7)	(9.1)	(32.6)	(173.9)	(53.2)	(23.1)	(303.6)
Transferred from Group undertakings	-	-	-	33.7	-	1.3	35.0
At the end of the year	32.0	6.6	90.4	79.1	27.3	40.1	275.5
Provisions were analysed as follows:							
Amounts falling due within one year	15.4	6.6	34.1	71.5	27.3	30.9	185.8
Amounts falling due after one year	16.6	-	56.3	7.6	-	9.2	89.7
Total provisions	32.0	6.6	90.4	79.1	27.3	40.1	275.5

Property

The Bank Company has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases. In addition, dilapidation provisions are recorded to the extent that the Bank Company has incurred dilapidations and/or the dilapidation clause within the contract has been invoked.

Financial Services Compensation Scheme (FSCS) levies

In common with other regulated UK deposit takers, the Bank Company pays levies to the FSCS to enable the FSCS to meet claims against it. During 2008 and 2009 claims were triggered against the FSCS in relation to a number of financial institutions. The compensation paid out to consumers is currently funded through loans from HM Treasury. The Bank Company could be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury. The ultimate FSCS levy to the industry as a result of the historic claims cannot currently be estimated reliably as it is dependent on various uncertain factors including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

By virtue of its holding deposits protected under the FSCS scheme the Bank Company has an obligation to pay levies in respect of the interest cost for 2017/18 scheme year. The interest rate chargeable on the loan and levied to the industry is subject to a floor equal to the higher of HM Treasury's own cost of borrowing and Sterling LIBOR with 12-month maturity.

The Bank Company has provided £2.4m as at 31 December 2017 (31 December 2016: £6.6m) for its share of the levies raised by the FSCS. The Bank Company's interest levy provision calculation includes estimates of the total FSCS levy in each levy year and estimates of the Bank Company's market participation in each levy year.

Payment Protection Insurance (PPI)

Provisions have been made in respect of potential customer compensation claims relating to past sales of PPI. Claims are investigated on an individual basis and, where appropriate, compensation payments are made. For a number of years the Bank Company, along with many other financial services providers, sold PPI alongside mortgage and non-mortgage credit products. The Bank Company stopped selling non-mortgage PPI in January 2009 and stopped selling mortgage PPI in March 2012.

An additional provision of £38.5m was recognised in the year (2016: £36.0m), in respect of the total expected cost of carrying out work and paying compensation related to historical PPI selling. The provision increase reflects increased complaint volumes ahead of the FCA imposed timebar of August 2019, the impact of marketing campaigns and the requirement to mail all previously rejected Plevin complaints. As a result, the total provision raised to date is £498.3m.

Conduct/legal provisions

During the period the Bank Company provided £0.4m (2016: £2.3m) in respect of interest income in relation to breaches of the technical requirements of the CCA.

The Bank Company made a net release of £11.5m (31 December 2016: £11.3m) of provision for customer redress. This includes a £0.5m (2016: £12.5m) net release on breaches of the technical requirements of the CCA as the remediation programme nears completion. There was a further release of £11.0m (2016: £15.3m) on other projects including mortgage issues of £9.6m (2016:16.5m net charge). The legacy mortgage issues covered in the previous years have been completed or reviewed in detail resulting in a reduced overall impact. A few residual mortgage issues remain under review with the current expectation of low to zero redress requirements. There has been no change to the packaged bank account programme as proactive remediation work coming to completion and inbound complaints volumes and average redress remain in line with expectations.

Other

Other provisions include provisions for severance costs, Pace separation and professional fees in relation to the Restructuring and Recapitalisation. Provisions are made where there is a present obligation and it is probable that expenditure will be made.

During 2017, the Bank Company has released £0.8m of the provisions previously made in respect of two long term incentive plans for senior executives, established in 2015 and 2016. This reflects the lower anticipated pay out from these plans, as a result of plan performance against specified metrics, the fall in the Bank Company's share price and the re-calculation of awards, based on new Holding Company shares. Accordingly a provision of £0.2m is included in the financial statements as at 31 December 2017 (31 December 2016: £0.6m). There was no long term incentive plan set up in 2017.

18. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using the most appropriate tax rate in respect of each temporary difference.

The UK corporation tax rate reduced from 20% to 19% (effective from 1 April 2017) and will reduce further to 17% effective from 1 April 2020; the latter rate change was enacted on 15 September 2016. A banking surcharge tax of 8% also applies to the Bank (effective from 1 January 2016). Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

The movements on the deferred tax asset accounts are as follows:

	2017	2016
Deferred tax at the beginning of the year	**1.6**	2.0
Credited/(charged) to the income statement:		
Current year	**7.4**	10.3
Prior year	**(0.3)**	-
Impact of corporation tax rate charge	**(1.2)**	(2.1)
	5.9	8.2
Credited/(charged) to other comprehensive income:		
Available for sale	**(1.1)**	2.5
Cash flow hedges	**8.8**	(7.3)
Unrealised appreciation on investments	**5.7**	-
Pension reserve	**(20.3)**	(3.8)
	(6.9)	(8.6)
Deferred tax at the end of the year	**0.6**	1.6
Components of net deferred tax:		
Deferred tax asset	**60.1**	38.7
Deferred tax liability	**(59.5)**	(37.1)
	0.6	1.6

The deferred tax asset above includes an offset for those deferred tax liabilities that are permissible to be offset. Net deferred tax assets expected to be recoverable after one year are £0.6m (2016: £1.6m).

	2017	2016
Deferred tax comprises:		
Capital allowances on fixed assets and assets leased to customers	**60.1**	38.7
Pensions and post-retirement benefits	**(39.4)**	(5.1)
Cash flow hedges	**(10.0)**	(17.4)
Unrealised appreciation on investments	**(6.1)**	(11.8)
Available for sale	**(4.0)**	(2.8)
	0.6	1.6

The deferred tax credit in the income statement comprises:

	2017	2016
Capital allowances on fixed assets and assets leased to customers	**(21.4)**	(16.4)
Cash flow hedges	**1.3**	(1.1)
Unrealised appreciation on investments	**0.1**	4.0
Pensions and post-retirement benefits	**14.1**	1.3
Capital losses	**-**	4.0
	(5.9)	(8.2)

Deferred tax assets totalling £410.8m (2016: £409.0m) have not been recognised where doubt exists over the availability of sufficient future taxable profits. Deferred tax has not been recognised in respect of trading losses of £2,059.9m (with deferred tax of £371.3m) and other temporary differences of £158.1m (with deferred tax of £39.5m).

New legislation was enacted in 2016 with the effect that from 1 April 2016, only 25% of a bank's taxable profits can be relieved by brought forward losses. The Government announced on 16 March 2016 that further changes to the rules on the utilisation of tax losses will be introduced effective from 1 April 2017; however the new legislation has not yet been enacted.

19. Pensions

Information on pensions is provided in note 29 of the consolidated financial statements.

20. Contingent liabilities

The tables below provide the contractual amounts and risk weighted amounts of contingent liabilities and commitments. The contractual amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the CRD IV rules.

The contingent liabilities, as detailed below, arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Audited	**Unaudited**	Audited	Unaudited
	Contractual amount 2017	**Risk weighted amount 2017**	Contractual amount 2016	Risk weighted amount 2016
Contingent liabilities:				
Guarantees and irrecoverable letters of credit	**15.4**	**5.3**	12.1	4.6
Other commitments:				
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[1]	**2,263.2**	**265.3**	2,277.4	296.2
	2,278.6	**270.6**	2,289.5	300.8

1. Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,211.2m (2016: £1,376.2m).

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Bank Company's day-to-day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirement. See note 24 to the Bank Company financial statements for further details of assets pledged.

Commitments under operating leases

The Bank Company leases various properties and equipment under non-cancellable operating lease arrangements. The leases have various terms, ranging from six months to 999 years. None of these leases are individually material and none have any material clauses. The table below discloses the minimum operating lease payments the Bank Company will be required to make over the remaining lives of the leases.

	Land and buildings 2017	Land and buildings 2016
Falling due:		
Within one year	**8.7**	12.2
Between one and five years	**25.8**	33.7
In five years or more	**72.2**	73.6
	106.7	119.5

The Bank Company leases a number of branch and office premises under operating leases. The leases typically run for a period of up to 25 years, with an option to renew the lease after that period. Lease payments are generally reviewed every three to five years to reflect market rentals.

The total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases for the Bank Company was £3.1m (2016: £4.2m).

Commitments to financially support subsidiary undertakings

Where relevant, the Bank Company has committed to financially support certain subsidiary undertakings.

21. Investments in subsidiaries/Group undertakings

	2017			2016		
	Ordinary shares	**Capital contributions**	**Total**	Ordinary shares	Capital contributions	Total
At the beginning of the year	**175.5**	**631.3**	**806.8**	565.9	648.5	1,214.4
Additions	**48.4**	**-**	**48.4**	148.5	303.1	451.6
Repayments	**(5.0)**	**-**	**(5.0)**	-	(320.3)	(320.3)
Reclassification to amounts owed by other Co-operative Bank undertakings	**-**	**(631.3)**	**(631.3)**	-	-	-
Impairment charge	**(167.3)**	**-**	**(167.3)**	(538.9)	-	(538.9)
At the end of the year	**51.6**	**-**	**51.6**	175.5	631.3	806.8

The £5.0m repayment relates to Britannia International Ltd share repurchase.

Subsidiary undertakings

Subsidiary undertakings which are registered in England and operating in the UK:

	Footnote		**Shareholding 2017**	Shareholding 2016
Co-operative Commercial Limited	1	Investment company	**100%**	100%
Second Roodhill Leasing Limited	1	Leasing	**100%**	100%
Third Roodhill Leasing Limited	1	Leasing	**100%**	100%
Fourth Roodhill Leasing Limited	1	Leasing	**100%**	100%
Britannia Treasury Services Limited	1	Holding company	**100%**	100%
Britannia Pension Trustees Limited	1	Pension scheme participant	**100%**	100%
BPS Principal Employer Limited	1	Holding company	**100%**	100%
Britannia Development and Management Company Limited	1	Property investment	**100%**	100%
Moorland Covered Bonds LLP	2	Mortgage acquisition and guarantor of covered bonds	**100%**	100%
Co-operative Bank Financial Advisers Limited	1	Inactive	**100%**	100%
Mortgage Agency Services Number One Limited	3	Former mortgage and syndicated lending	**100%**	100%
Mortgage Agency Services Number Two Limited	3	Former mortgage lending	**100%**	100%
Mortgage Agency Services Number Four Limited	3	Mortgage lending	**100%**	100%
Mortgage Agency Services Number Five Limited	3	Mortgage lending	**100%**	100%
Mortgage Agency Services Number Six Limited	3	Former mortgage lending	**100%**	100%
Platform Home Loans Limited	1	Mortgage lending	**100%**	100%
Platform Funding Limited	1	Mortgage lending	**100%**	100%

Registered in the Isle of Man and operating overseas:

Britannia International Limited	Deposit taking

Britannia International Limited company surrendered its Class 1 Deposit-Taking Licence to the Isle of Man Financial Supervision Commission during 2015. Any remaining customer accounts were closed and placed into a scheme to manage these funds.

Securitisation vehicles

The results of the following securitisation vehicles are consolidated into the results of the Bank Company:

	Footnote	
Silk Road Finance Number Four plc	4	Securitisation company
Calico Finance Number One DAC	5	Securitisation company

All securitisation vehicles are registered in England and operate in the UK, with the exception of Calico Finance Number One DAC, which is registered and operated in the Republic of Ireland.

All of the above companies are related parties to the Bank Company. See note 22 to the Bank Company financial statements for the related party disclosures. The following securitisation vehicles were placed into liquidation by the Bank Company during 2017:

		Date of liquidation
Leek Finance Number Nineteen plc	Securitisation company	25 October 2017

Joint Ventures

The Bank Company has investments in the following joint ventures:

	Ownership 2017	Ownership 2016
Britannia Personal Lending Limited	**49%**	49%
Britannia New Homes (Scotland) Limited (Dormant)	**50%**	50%

Britannia Personal Lending Limited has its registered office at Trinity Road, Halifax, HX1 2RG.

Britannia New Homes (Scotland) Limited has its registered office at 140 West George Street, Glasgow, G2 2HG.

See note 31 to the consolidated financial statements for further details of joint ventures.

Dormant Companies

The Bank Company has investments in the following dormant subsidiaries all of which are registered in England:

	Footnote
Cleveland Finance Limited	1
Day & Son (Builders) Limited	1
The Co-operative Bank Pension Trust Limited	1

Footnote	Registered office at:
1	PO Box 1011 Balloon Street, Manchester, M60 4EP
2	Secretariat Miller Street Tower, Miller Street, Manchester, England, M60 0AL
3	1 Angel Square, Manchester, United Kingdom, M60 0AG
4	35 Great St. Helen's, London, EC3A 6AP
5	Fourth Floor, 3 George’s Dock, IFSC, Dublin 1, Ireland

22. Related party transactions

Parent, subsidiary and ultimate controlling party

The ultimate parent undertaking of the Bank Company is The Co-operative Bank Holdings Limited (Holding Company). The Co-operative Bank Holdings Limited became the new Holding Company for The Co-operative Bank plc and its subsidiaries by way of a share for share exchange with its shareholders.

As at 31 December 2017, the Group had two significant shareholders, SP Coop Investment, Ltd and Goldentree Asset Management Lux S.A.R.L., each holding over 20% of the B shares of the Holding Company.

The B Shareholders Agreement grants certain rights to shareholders, where the B shareholders are entitled to appoint up to two Directors to the Board of the Holding Company, and the Holding Company is entitled to appoint up to two Directors to the Board of the Bank, who are designated as B Directors of the Holding Company and Bank. Further information of the rights of the A and B shareholders are detailed in the Ownership section of the Corporate Governance Report on page 35, as well as the details of the B Shareholders Agreement.

On 6 March 2018, Goldentree Asset Management Lux S.A.R.L. reduced its Class A shareholding in the Holding Company and as a result, it's entitlement to B shares reduced. As of that date, Goldentree Asset Management Lux S.A.R.L. which has been disclosed as a related party as at 31 December 2017, would no longer be considered a related party on account of holding less than 20% of the B shares of the Holding Company.

At 31 December 2017, the Bank Company is an associate of, and therefore a related party of, SP Coop Investment, Ltd and Goldentree Asset Management Lux S.A.R.L. Prior to the Restructuring and Recapitalisation, Co-operative Group was a significant shareholder in the Bank, and had the right to Bank Board representation. Therefore Co-operative Group has been considered a related party of the Bank Company during the year up until the Restructuring and Recapitalisation on 1 September 2017, and there have been material transactions between the two companies during this year.

Transactions with Co-operative Group

The Bank Company continues to progress with separation from Co-operative Group and remains subject to legal agreements entered into and indemnities provided prior to separation. The Bank has also entered into new agreements with Co-operative Group in relation to IT, the provision of tax losses and estates, as part of separation.

The Chair of the Bank's Audit Committee and Non-Executive Director Glyn Smith is also a Non-Executive Director of a not-for-profit subsidiary of Co-operative Group, Reclaim Fund Limited (RFL), from which Co-operative Group derives no financial benefit.

Further details of the transactions with Co-operative Group and its subsidiary undertakings are disclosed in note 32 to the consolidated financial statements.

Surrendered loss debtor

As part of the negotiations relating to the separation of the Bank from Co-operative Group, the Bank and Co-operative Group also agreed terms relating to the surrender of tax losses between the entities in the Bank's tax group and entities in Co-operative Group tax group. A deed sets out the basis of the agreement by Co-operative Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 2013. The deed also addresses the terms of the payment by Co-operative Group to the Bank for those tax losses. The 2017 Bank Company financial statements, which include a surrendered loss debtor of £55.0m (2016 Restated: £61.1m), have been prepared on a basis consistent with the deed. The Bank receives payment from Co-operative Group when Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised. These amounts are included within Other Assets.

Balances with Parent and other Co-operative Bank undertakings

The following tables show the value of transactions with The Co-operative Bank plc undertakings during the year.

Amounts owed by Parent and Co-operative Bank undertakings	2017	Re-presented[1] 2016
Amounts owed by Co-operative Bank subsidiaries (excluding special purpose entities)	**1,305.4**	898.8
Amounts owed by Co-operative Bank subsidiaries - special purpose entities	**16.8**	207.5
	1,322.2	1,106.3
Investment securities held by Co-operative Bank in subsidiaries – special purpose entities	**1,350.0**	-
	2,672.2	1,106.3

Amounts owed to Parent and Co-operative Bank undertakings	2017	Re-presented[1] 2016
Amounts owed to Co-operative Bank subsidiaries (excluding special purpose entities)	**1,206.9**	1,538.5
Amounts owed to Co-operative Bank subsidiaries - special purpose entities	**1,298.8**	602.5
	2,505.7	2,141.0
Derivative liabilities to Co-operative Bank subsidiaries (excluding special purpose entities)	**-**	46.5
Derivative liabilities to Co-operative Bank subsidiaries - special purpose entities	**-**	15.0
	2,505.7	2,202.5
Cash balances deposited with the Bank Company by Co-operative Bank subsidiaries (excluding special purpose entities)	**0.5**	133.3
Cash balances deposited with the Bank Company by The Co-operative Bank Holdings Limited	**0.2**	-
	2,506.4	2,335.8

1. The comparative figures for Cash balances deposited with the Bank Company by Co-operative Bank subsidiaries have been re-presented between the above tables to more fairly reflect their nature.

During the year a number of subsidiaries were dissolved, which previously would have been related parties of the Bank Company.

The following tables show the value of transactions with The Co-operative Bank plc undertakings during the year.

2017	Interest and fees paid to Bank Company	Interest and fees received from Bank Company	Staff recharges paid to Bank Company	Rent received from Bank Company	Administration recharge paid to Bank Company
Transactions with Co-operative Bank subsidiaries (excluding special purpose entities)	**30.8**	**29.6**	**-**	**0.5**	**-**
Transactions with Co-operative Bank subsidiaries - special purpose entities	**25.7**	**23.2**	**-**	**-**	**-**
	56.5	**52.8**	**-**	**0.5**	**-**

2016	Interest and fees paid to Bank Company	Interest and fees received from Bank Company	Staff recharges paid to Bank Company	Rent received from Bank Company	Administration recharge paid to Bank Company
Transactions with Co-operative Bank subsidiaries (excluding special purpose entities)	83.1	39.4	1.1	0.9	1.9
Transactions with Co-operative Bank subsidiaries - special purpose entities	27.3	42.5	-	-	-
	110.4	81.9	1.1	0.9	1.9

Transactions with Directors, key management personnel and close family

Details of the Bank Company's transactions with Directors, key management personnel and close family are as set out in note 32 to the consolidated financial statements.

23. Share capital

Information on share capital is provided in note 33 to the consolidated financial statements.

24. Fair values of financial assets and liabilities

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
2017							
Assets							
Cash and balances at central banks	-	-	4,032.0	-	-	-	4,032.0
Loans and advances to banks	-	-	460.3	-	-	-	460.3
Loans and advances to customers	3.2	175.0	16,430.0	-	-	-	16,608.2
Investment securities	-	-	1,450.0	2,287.7	-	-	3,737.7
Derivative financial instruments	147.9	-	-	-	-	49.5	197.4
Equity shares	-	-	-	24.3	-	-	24.3
Amounts owed by other Co-operative Bank undertakings	-	-	1,322.2	-	-	-	1,322.2
Other assets	-	-	79.3	-	-	-	79.3
Total financial assets	151.1	175.0	23,773.8	2,312.0	-	49.5	26,461.4
Non-financial assets							438.3
Total assets							26,899.7
Liabilities							
Deposits by banks	-	-	-	-	1,122.7	-	1,122.7
Customer accounts	-	-	-	-	20,635.7	-	20,635.7
Customer accounts – capital bonds	-	-	-	-	-	-	-
Debt securities in issue	-	-	-	-	600.7	-	600.7
Derivative financial instruments	167.0	-	-	-	-	141.8	308.8
Other borrowed funds	-	-	-	-	-	-	-
Amounts owed to other Co-operative Bank undertakings	-	-	-	-	2,505.7	-	2,505.7
Other liabilities	-	-	-	-	33.9	-	33.9
Total financial liabilities	167.0	-	-	-	24,898.7	141.8	25,207.5
Non-financial liabilities							228.6
Total liabilities							25,436.1
Capital and reserves							1,463.6
Total liabilities and equity							26,899.7

Whilst the Company does not hold any derivative financial instruments that are considered ‘derivatives held for trading purposes’, IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as ‘held for trading’.

Fair value disclosures throughout this note have been calculated in accordance with IFRS 13, which values assets individually, rather than as a portfolio or as part of a business combination.

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
Re-presented[1] 2016							
Assets							
Cash and balances at central banks	-	-	2,848.2	-	-	-	2,848.2
Loans and advances to banks	-	-	440.5	-	-	-	440.5
Loans and advances to customers	4.1	188.9	19,100.4	-	-	-	19,293.4
Investment securities	-	-	34.8	3,538.1	-	-	3,572.9
Derivative financial instruments	165.7	-	-	-	-	95.5	261.2
Equity shares	-	-	-	44.8	-	-	44.8
Amounts owed by other Co-operative Bank undertakings	-	-	1,106.3	-	-	-	1,106.3
Other assets	-	-	148.9	-	-	-	148.9
Total financial assets	169.8	188.9	23,679.1	3,582.9	-	95.5	27,716.2
Non-financial assets							1,128.4
Total assets							28,844.6
Liabilities							
Deposits by banks	-	-	-	-	1,020.0	-	1,020.0
Customer accounts	-	-	-	-	22,558.5	-	22,558.5
Customer accounts – capital bonds	-	11.8	-	-	-	-	11.8
Debt securities in issue	-	-	-	-	1,006.8	-	1,006.8
Derivative financial instruments	245.9	-	-	-	-	249.9	495.8
Other borrowed funds	-	-	-	-	472.6	-	472.6
Amounts owed to other Co-operative Bank undertakings	-	-	-	-	2,141.0	-	2,141.0
Other liabilities	-	-	-	-	44.9	-	44.9
Total financial liabilities	245.9	11.8	-	-	27,243.8	249.9	27,751.4
Non-financial liabilities							366.8
Total liabilities							28,118.2
Capital and reserves							726.4
Total liabilities and equity							28,844.6

1. The comparative figures have been re-presented to more fairly reflect their nature. Further information can be found in notes 3 and 12 to the Bank Company financial statements.

a) Use of financial assets and liabilities
Refer to note 34 to the consolidated financial statements for details of the use of financial instruments.

b) Valuation of financial assets and liabilities measured at fair value
The carrying values of financial assets and liabilities measured at fair value are determined in compliance with the accounting policies in note 1 to the consolidated financial statements and analysed in the following tables by the three level fair value hierarchy defined as follows:
- Level 1 – Quoted market prices in active markets
- Level 2 – Valuation techniques using observable inputs
- Level 3 – Valuation techniques using unobservable inputs

	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
2017				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	**-**	**3.2**	**-**	**3.2**
Designated at fair value:				
Loans and advances to customers	**-**	**171.2**	**3.8**	**175.0**
Available for sale financial assets:				
Investment securities	**1,462.3**	**1.9**	**823.5**	**2,287.7**
Equity shares	**0.3**	**-**	**24.0**	**24.3**
Derivative financial assets	**-**	**197.4**	**-**	**197.4**
Non-financial assets				
Investment properties	**-**	**-**	**2.3**	**2.3**
Total assets carried at fair value	**1,462.6**	**373.7**	**853.6**	**2,689.9**
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	**-**	**-**	**-**	**-**
Derivative financial liabilities	**-**	**308.8**	**-**	**308.8**
Total liabilities carried at fair value	**-**	**308.8**	**-**	**308.8**

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2016				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	-	4.1	-	4.1
Designated at fair value:				
Loans and advances to customers	-	184.0	4.9	188.9
Available for sale financial assets:				
Investment securities	2,230.7	-	1,307.4	3,538.1
Equity shares	0.2	25.3	19.3	44.8
Derivative financial assets	-	261.2	-	261.2
Non-financial assets				
Investment properties	-	-	2.2	2.2
Total assets carried at fair value	2,230.9	474.6	1,333.8	4,039.3
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	-	11.8	-	11.8
Derivative financial liabilities	-	434.2	61.6	495.8
Total liabilities carried at fair value	-	446.0	61.6	507.6

Key considerations in the calculation of fair values for financial assets and liabilities measured at fair value are as follows:

Level 1 – Quoted market prices in active markets
Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

Level 2 – Valuation techniques using observable inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The valuation techniques used to value these instruments employ only observable market data and relate to the following assets and liabilities:

- **Loans and advances to customers**
  Loans and advances to customers primarily relate to corporate loans of £158.1m as at 31 December 2017 (2016: £178.1m), which are fair valued through profit or loss using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

- **Investment securities – available for sale**
  Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

- **Derivative financial instruments**
  Over-the-counter (i.e. non-exchange traded) derivatives are valued using valuation models which are based on observable market data. Valuation models calculate the present value of expected future cash flows, based upon 'no arbitrage' principles. The Company enters into vanilla foreign exchange and interest rate swap derivatives, for which modelling techniques are standard across the industry. Examples of inputs that are generally observable include foreign exchange spot and forward rates, and benchmark interest rate curves.

Level 3 – Valuation techniques using unobservable inputs
This is used for financial instruments valued using models where one or more significant inputs are not observable.

The proportion of financial assets valued based on significant unobservable inputs are analysed as follows:

- **Loans and advances to customers**
  Loans and advances to customers include 25 year fixed rate mortgages of £3.8m as at 31 December 2017 (2016: £4.9m), which are fair valued through profit or loss using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has decreased the valuation by £0.2m in 2017 (2016: £0.2m increase). A reasonable change in the assumptions would not result in any material change in the valuation.

- **Investment securities – available for sale**
  Investment securities – available for sale include RMBS of £823.5m at 31 December 2017 (2016: £1,307.4m), which are fair valued through other comprehensive income. An independent third party valuation agent is used to provide prices obtained from large financial institutions. These prices are indicative values only and do not represent an offer to purchase the securities. These RMBS represent the Company's interest in unconsolidated structured entities.

  A 1% increase or decrease in the price of the notes will result in the value increasing or decreasing by approximately £8.2m respectively.

- **Equity shares**
  Equity shares include US Dollar denominated convertible preference shares in Visa International, which are classified as available for sale, with any movements in fair value being recognised through other comprehensive income. The fair value of the Visa International shares has been calculated by taking the period end NYSE share price and discounting for illiquidity and clawback.

  If the illiquidity premium to the discount rate was assumed to be double, it would result in a reduction in the overall fair value of the equity shares of £4.3m as at 31 December 2017 (17.9%).

- **Investment properties**
  Investment properties within level 3 are valued by using the original price, index linked at the balance sheet date using the relevant house price index.

Movements in fair values of instruments with significant unobservable inputs (level 3) were:

	Fair value at the beginning of the year	**Purchases and transfers in**	**Sales, transfers out and repayments**	**Other comprehensive income**	**Income statement**	**Fair value at the end of the year**
2017						
Loans and advances to customers	**4.9**	**-**	**(0.9)**	**-**	**(0.2)**	**3.8**
Investment securities	**1,307.4**	**4.2**	**(500.8)**	**5.0**	**7.7**	**823.5**
Equity shares	**19.3**	**-**	**-**	**4.7**	**-**	**24.0**
Investment properties	**2.2**	**-**	**-**	**-**	**0.1**	**2.3**
Derivative liabilities	**(61.6)**	**-**	**61.6**	**-**	**-**	**-**
	1,272.2	**4.2**	**(440.1)**	**9.7**	**7.6**	**853.6**
2016						
Loans and advances to customers	5.5	-	(0.8)	-	0.2	4.9
Investment securities	1,599.8	-	(306.5)	9.0	5.1	1,307.4
Equity shares	51.2	16.1	(58.2)	13.5	(3.3)	19.3
Investment properties	2.1	-	(0.1)	-	0.2	2.2
Derivative liabilities	(61.3)	-	-	-	(0.3)	(61.6)
	1,597.3	16.1	(365.6)	22.5	1.9	1,272.2

c) Fair values of financial assets and liabilities not carried at fair value

The carrying values of financial assets and liabilities measured at amortised cost are determined in compliance with the accounting policies in note 1 to the consolidated financial statements and their fair values are analysed in the following tables by the three level fair value hierarchy set out above.

		Fair value				
	Total carrying value	**Level 1**	**Level 2**	**Level 3**	**Items where fair value approximates carrying value**	**Total**
2017						
Financial assets						
Cash and balances at central banks	**4,032.0**	**-**	**-**	**-**	**4,032.0**	**4,032.0**
Loans and advances to banks	**460.3**	**-**	**9.3**	**-**	**450.5**	**459.8**
Loans and advances to customers	**16,430.0**	**-**	**-**	**14,594.7**	**1,604.0**	**16,198.7**
Investment securities	**1,450.0**	**-**	**-**	**1,448.8**	**-**	**1,448.8**
Amounts owed by other Co-operative Bank undertakings	**1,322.2**	**-**	**658.9**	**-**	**720.3**	**1,379.2**
Other assets	**79.3**	**-**	**-**	**53.5**	**24.3**	**77.8**
Financial liabilities						
Deposits by banks	**1,122.7**	**-**	**1,115.9**	**-**	**3.4**	**1,119.3**
Customer accounts	**20,635.7**	**-**	**-**	**5,452.1**	**15,203.9**	**20,656.0**
Debt securities in issue	**600.7**	**658.2**	**-**	**-**	**-**	**658.2**
Other borrowed funds	**-**	**-**	**-**	**-**	**-**	**-**
Amounts owed to other Co-operative Bank undertakings	**2,505.7**	**-**	**-**	**1,173.6**	**1,321.5**	**2,495.1**
Other liabilities	**33.9**	**-**	**-**	**-**	**33.9**	**33.9**

		Fair value				
	Total carrying value	Level 1	Level 2	Level 3	Items where fair value approximates carrying value	Total
Re-presented[1] 2016						
Financial assets						
Cash and balances at central banks	2,848.2	-	-	-	2,848.2	2,848.2
Loans and advances to banks	440.5	-	9.5	-	431.0	440.5
Loans and advances to customers	19,100.4	-	-	17,012.6	1,366.3	18,378.9
Investment securities	34.8	35.4	-	-	-	35.4
Amounts owed by other Co-operative Bank undertakings	1,106.3	-	691.5	167.3	318.6	1,177.4
Other assets	148.9	-	-	61.1	87.8	148.9
Financial liabilities						
Deposits by banks	1,020.0	-	990.7	-	29.3	1,020.0
Customer accounts	22,558.5	-	-	6,172.6	16,429.9	22,602.5
Debt securities in issue	1,006.8	1,058.8	-	-	-	1,058.8
Other borrowed funds	472.6	-	363.6	-	-	363.6
Amounts owed to other Co-operative Bank undertakings	2,141.0	-	-	1,359.6	768.1	2,127.7
Other liabilities	44.9	-	-	-	44.9	44.9

1. The comparative figures for loans and advances to banks and deposits by banks have been re-presented to more fairly reflect their nature. Further information can be found in notes 3 and 12 to the Bank Company financial statements. The level disclosures have been re-presented to better reflect how the fair value was determined.

Key considerations in the calculation of fair values for loans and receivables and financial liabilities at amortised cost are as follows:

Level 1 – Quoted market prices in active markets
Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

Level 2 – Valuation techniques using observable inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The valuation techniques used to value these instruments employ only observable market data and relate to the following assets and liabilities:

- **Loans and advances to banks/deposits by banks**
  Loans and advances to banks include interbank placements and items in the course of collection.

  The amortised cost value of all loans and advances to banks are deemed to be a close approximation of their fair value due to their short maturity. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.

- **Amounts owed by other Co-operative Bank undertakings**
  Amounts owed by other Co-operative Bank undertakings include debt securities and subordinated debt held in the Company's own securitisation vehicles. Fair value is based on available market prices; where these are not available quoted market prices for similar debt securities, with adjustments to take into account the subordination of the particular loan note, have been used to estimate fair value.

Level 3 – Valuation techniques using unobservable inputs
This is used for financial instruments valued using models where one or more significant inputs are not observable.

The proportion of financial assets valued based on significant unobservable inputs are analysed as follows:

- **Loans and advances to customers**
  The fair value of loans and advances to customers in total is 98.6% of the carrying value as at 31 December 2017 (2016: 96.2%). The increase in 2017 is largely due to the Warwick Finance Three securitisation during the year, where the Company sold a large number of the lower-valued Optimum mortgages.

  The overall fair value is less than par primarily due to two main factors:
  - customer interest rates are below the market rate for the period until expected maturity or the repricing date, if earlier
  - credit risk adjustments due to incurred and expected future credit losses

  Fixed rate loans and advances to customers are revalued to fair value based on future interest cash flows (at funding rates) and principal cash flows discounted using an appropriate market rate. The market rate applied in the calculation is the average market rate for new originations of loans with similar characteristics to the book of loans being valued, and reflects the current low interest rate environment. This rate is assumed to encompass the time value of money, plus a risk premium to account for the inherent uncertainty in the timing and amount of future cash flows arising from a book of loans assets.

  Forecast principal repayments are based on redemption at the earlier of maturity or re-pricing date with some overlay for historical behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed that there would be no other factors which market participants would take into account when assessing the fair value of the loan assets. It is assumed that there is no fair value adjustment required in respect of interest rate movement on standard variable rate loan assets, as the interest rate being charged is assumed to be equal to the market rate for those loan assets.

  Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available.

- **Investment securities – loans and receivables**
  Investment securities – loans and receivables include:
  - RMBS measured at amortised cost of £87.0m as at 31 December 2017 (2016: £nil), being a 5% regulatory holding of unconsolidated structured entities. The remaining 95% is privately held, therefore there are no available market prices. An in-house model is used that sources independent market data for disclosure purposes only.
  - Securities measured at amortised cost of £13.0m as at 31 December 2017 (2016: £13.8m) that moved from Level 1 to Level 3. The move is due to the quoted price being in an inactive market.
  - Investment securities measured at amortised cost of £1,350.0m as at 31 December 2017 (2016: £nil), being a 100% holding of the Silk Road 4 buyback. As 100% is held, there are no available market prices. An in-house model is used that sources independent market data for disclosure purposes only.

- **Other assets**
  Other assets include the surrendered loss debtor with an amortised cost of £55.0m as at 31 December 2017 (2016: £61.1m). The fair value of the surrendered loss debtor as at 31 December 2017 is estimated using unobservable inputs to be £53.5m. The fair value as at 31 December 2017 was determined by discounting the expected cash flows under the terms of the agreement with Co-operative Group. Cash flows are discounted at a discount rate reflecting the yield of the longest maturity Co-operative Group bond in issue (adjusted to reflect the weighted average maturity of cash flows due from Co-operative Group), plus a premium to estimate the uncertainties associated with the matters set out in note 2.7 to the consolidated financial statements. The premium is calculated applying risk parameter estimation theory using observable inputs from related (but not identical) financial instruments or indices. The fair value as at 31 December 2016 has been included in level 3, but was determined to approximate to amortised cost.

- **Customer accounts**
  The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on future interest cash flows (at funding rates) and principal cash flows, discounted using an appropriate market rate.

- **Amounts owed to other Co-operative Bank undertakings**
  Amounts owed to other Co-operative Bank undertakings relate to deemed loans owed to the Company's own securitisation vehicles; these have been modelled using expected cash flows, based on redemption profiles, discounted at a market rate.

d) Fair value of transferred assets and associated liabilities
Assets pledged
Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Company's day-to-day operations.

	Carrying amount of assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net fair value position
2017					
Investments securities sold under repurchase agreements	**1,595.4**	**1,120.4**	**1,595.4**	**1,120.4**	**475.0**
Re-presented[1] 2016					
Investments securities sold under repurchase agreements	1,260.1	990.6	1,260.1	990.6	269.5

1. The comparative figures have been re-presented to more fairly reflect their nature. Further information can be found in notes 3 and 12 to the Bank Company financial statements.

Assets sold under repurchase agreements include mortgage backed securities (£775.3m of assets and associated liabilities of £300.1m) and UK government gilts (£820.1m of assets and associated liabilities of £820.3m).

25. Bank Company analysis of credit risk exposure

2017	Loans and advances to banks £m	Loans and advances to customers £m	Investment Securities Loans and receivables £m	Investment Securities Available for sale £m	Derivative financial instruments £m	Total £m
Analysis of balance in note	3	4	5	5	6	
Gross balance	**460.3**	**16,687.1**	**1,450.0**	**2,287.7**	**197.4**	**21,082.5**
Less: allowance for losses	**-**	**(78.9)**	**-**	**-**	**-**	**(78.9)**
	460.3	**16,608.2**	**1,450.0**	**2,287.7**	**197.4**	**21,003.6**
Analysis of credit risk exposure	**-**		**-**	**-**	**-**	
Not impaired	**460.3**	**16,290.2**	**1,450.0**	**2,287.7**	**197.4**	**20,685.6**
Impaired	**-**	**396.9**	**-**	**-**	**-**	**396.9**
	460.3	**16,687.1**	**1,450.0**	**2,287.7**	**197.4**	**21,082.5**
Credit commitments	**-**	**2,411.0**	**-**	**-**	**-**	**2,411.0**
Gross credit risk exposure	**460.3**	**19,098.1**	**1,450.0**	**2,287.7**	**197.4**	**23,493.5**
Less allowances for losses	**-**	**(78.9)**	**-**	**-**	**-**	**(78.9)**
Net credit risk exposure	**460.3**	**19,019.2**	**1,450.0**	**2,287.7**	**197.4**	**23,414.6**

2016 (Restated)[1]	Loans and advances to banks £m	Loans and advances to customers £m	Investment Securities Loans and receivables £m	Investment Securities Available for sale £m	Derivative financial instruments £m	Total £m
Analysis of balance in note	3	4	5	5	6	
Gross balance	440.5	19,421.7	34.8	3,538.1	261.2	23,696.3
Less: allowance for losses	-	(128.3)	-	-	-	(128.3)
	440.5	19,293.4	34.8	3,538.1	261.2	23,568.0
Analysis of credit risk exposure						
Not impaired	440.5	18,718.2	34.8	3,538.1	261.2	22,992.8
Impaired	-	703.5	-	-	-	703.5
	440.5	19,421.7	34.8	3,538.1	261.2	23,696.3
Credit commitments		2,441.7	-	-	-	2,441.7
Gross credit risk exposure	440.5	21,863.4	34.8	3,538.1	261.2	26,138.0
Less allowances for losses	-	(128.3)	-	-	-	(128.3)
Net credit risk exposure	440.5	21,735.1	34.8	3,538.1	261.2	26,009.7

1. The above table has been restated to show an updated split between not impaired and impaired assets for the Loans and advances to customers (as reported in the 2017 Interim Accounts).

The Credit Risk section within Risk Management applies to the Bank Company where relevant and therefore no additional disclosures are included in this note.

26. Events after the balance sheet date

Information on events after the balance sheet date is provided in note 36 of the consolidated financial statements.

The Co-operative Bank Holdings Limited balance sheet
As at 31 December 2017
All amounts are stated in £m unless otherwise indicated

	Note	2017
Assets		
Loans and advances to banks	2	**0.2**
Investments in subsidiaries/group undertakings	3	**333.0**
Total assets		**333.2**
Total liabilities		**-**
Capital and reserves attributable to the Holding Company's equity holders		
Ordinary share capital	4	**0.9**
Share premium account	4	**313.8**
Merger relief reserve		**18.5**
Total equity		**333.2**
Total liabilities and equity		**333.2**

Net profit attributable to equity holders of the Holding Company is £nil.

The notes on pages 206 to 207 form part of these financial statements.

Approved by the Board on 13 March 2018

Dennis Holt	Liam Coleman	Tom Wood
Chairman	Chief Executive Officer	Chief Financial and Restructuring Officer

The Co-operative Bank Holdings Limited statement of cash flows
For the period ended 31 December 2017
All amounts are stated in £m unless otherwise indicated

	2017
Cash flows used in operating activities:	
Profit before taxation	-
Increase in loans and advances to banks	**(0.2)**
Net movement of other assets and other liabilities	**(0.1)**
Net cash flows used in operating activities	**(0.3)**
Cash flows used in investing activities:	
Investment in subsidiaries	**(250.0)**
Net cash flows used in investing activities	**(250.0)**
Cash flows from financing activities:	
Proceeds from issue of shares	**250.3**
Net cash flows from financing activities	**250.3**
Net increase/(decrease) in cash and cash equivalents	**-**
Increase in cash and cash equivalents	
Cash and cash equivalents at the beginning of the financial period	**-**
Cash and cash equivalents at the end of the financial period	**-**

The notes on pages 206 to 207 form part of these financial statements.

The Co-operative Bank Holdings Limited statement of changes in equity
For the period ended 31 December 2017
All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Holding Company			
	Share capital	**Share premium**	**Merger relief reserve**	**Total equity**
2017				
Balance at the beginning of the period	-	-	-	-
Total comprehensive income for the period	-	-	-	-
Issuance of share capital and bank acquisition	0.9	313.8	18.5	333.2
Balance at the end of the period	**0.9**	**313.8**	**18.5**	**333.2**

The notes on pages 206 to 207 form part of these financial statements.

NOTES TO THE HOLDING COMPANY FINANCIAL STATEMENTS
All amounts are stated in £m unless otherwise indicated

1. Basis of preparation
The Holding Company was incorporated in the UK and registered in England and Wales under the name of Balloon Street Holdings Limited on 13 July 2017. The name of the Holding Company was changed from Balloon Street Holdings Limited to The Co-operative Bank Holdings Limited on 1 September 2017. On 1 September 2017 the Holding Company became the new Holding Company for The Co-operative Bank plc and its subsidiaries by way of a share for share exchange.

The Holding Company financial statements have been prepared under the historic cost convention and approved by the Directors in accordance with IFRS as issued by the International Accounting Standards Board (IASB), and as adopted by the European Union (EU). The first accounting period for the Holding Company runs from 13 July 2017 to 31 December 2017.

On including its financial statements within the Group's Annual Report and Accounts, the Holding Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual income statement and related notes.

Accounting policies outlined in note 1 to the consolidated financial statements also apply to the Holding Company.

2. Loans and advances to banks

	2017
Loans and advances to banks	**0.2**

This balance is held with The Co-operative Bank plc.

3. Investments in subsidiaries/group undertakings

	2017
Investments in subsidiaries/group undertakings	**333.0**

The Holding Company owns 100% of the share capital of The Co-operative Bank plc. The Co-operative Bank plc has a number of subsidiary companies of its own, details of which are outlined in note 21 to the Bank Company financial statements.

4. Share capital

	2017				
	No. of A shares (millions)	A share capital	No. of B shares	B share capital	Total share capital
Allotted, called up and fully paid					
At the beginning of the period	-	-	-	-	-
Issued during the period	**9,029.1**	**0.9**	**67**	-	**0.9**
Cancelled during the period	-	-	**(1)**	-	-
At the end of the period	**9,029.1**	**0.9**	**66**	-	**0.9**

Share premium account	
At the beginning of the period	-
Premium on shares issued during the period	**313.8**
At the end of the period	**313.8**

On 13 July 2017, The Co-operative Bank Holdings Limited was incorporated with 451,457 ordinary shares of £0.10 each. On 1 September 2017, each incorporation share was sub-divided by 1,000 into 451,457,000 ordinary shares of £0.0001 each and reclassified as A shares. In addition, on 1 September 2017, The Co-operative Bank Holdings Limited became the new holding company for The Co-operative Bank plc and its subsidiaries by way of a share for share exchange with its shareholders. The Co-operative Bank Holdings Limited allotted and issued an additional 8,577,673,200 A shares of £0.0001 each and 65 fully paid B redeemable preference shares of £0.01 each to qualifying A shareholders as part of the Restructuring and Recapitalisation of The Co-operative Bank plc. The merger relief reserve was recognised on the issuance of Holding Company shares in exchange for the acquisition of the entire share capital of The Co-operative Bank plc.

The holders of the ordinary A shares hold limited voting rights but are entitled to participate in distributions and to receive a dividend on liquidation. The B shareholders have one vote for every share held and also benefit from certain governance, notification and approval rights with respect to the new Holding Company group but will have no rights to distributions, other than on exit in an amount of £25m in aggregate, subject to achieving a minimum valuation threshold.

5. Related party transactions

Parent, subsidiary and ultimate controlling party

The ultimate parent undertaking of the Group is The Co-operative Bank Holdings Limited. The Co-operative Bank Holdings Limited became the new Holding Company for The Co-operative Bank plc and its subsidiaries by way of a share for share exchange with its shareholders.

As at 31 December 2017, the Holding Company had two significant shareholders, SP Coop Investment, Ltd and Goldentree Asset Management Lux S.A.R.L., each holding over 20% of the B shares.

On 6 March 2018, Goldentree Asset Management Lux S.A.R.L. reduced its Class A shareholding in the Holding Company and as a result, it's entitlement to B shares reduced. As of that date, Goldentree Asset Management Lux S.A.R.L. which has been disclosed as a related party as at 31 December 2017, would no longer be considered a related party on account of holding less than 20% of the B shares of the Holding Company.

Balances with related parties

The following table shows the value of transactions with related parties during the period.

Amounts owed by Group undertakings	**2017**
Amounts owed by The Co-operative Bank plc	**0.2**

The subsidiaries of The Co-operative Bank plc as detailed in note 21 to the Bank Company financial statements, as well as all Directors and key management personnel of the Group, are considered to be related parties of the Holding Company. Further details are available in note 32 to the consolidated financial statements.

Other Information

SHAREHOLDER INFORMATION

For The Co-operative Bank Holdings Limited

Registered office

PO Box 101
1 Balloon Street
Manchester
M60 4EP
Reg. No. 10865342 (England)

Tel: 0161 832 3456
Tel: 0370 702 0003

Registrar

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS13 8AE

SHAREHOLDER INFORMATION

For The Co-operative Bank Plc

Registered office

PO Box 101
1 Balloon Street
Manchester
M60 4EP
Reg. No. 990937 (England)

Tel: 0161 832 3456
Tel: 0370 702 0003

FORWARD-LOOKING STATEMENTS

Caution about forward-looking statements

This document contains forward-looking statements with respect to the business, strategy and plans of The Co-operative Bank Holdings Limited and The Co-operative Bank plc (including its 2018-2022 Financial Plan or the Plan) and its current targets, goals and expectations relating to its future financial condition, performance, developments and/or prospects. Forward-looking statements sometimes use words such as 'may', 'will', 'seek', 'continue', 'aim', 'anticipate', 'target', 'projected', 'expect', 'estimate', 'intend', 'plan', 'goal', 'believe', 'achieve', 'predict', 'should' or in each case, their negative or other variations or comparable terminology, or by discussion of strategy, plans, objectives, goals, future events or intentions. Examples of such statements include statements regarding the Group's future financial position and commitments in connection with the Plan and other statements that are not historical fact.

Limitations inherent to forward-looking statements

The Bank cautions readers that these forward–looking statements are not historical facts or guarantees of future performance. By their nature, forward-looking statements involve risk and uncertainty because they are based on current plans, estimates, targets, projections, views and assumptions and are subject to significant inherent risks, uncertainties and other factors both external and internal relating to the Group's Plan, strategy or operations, which may result in the Group being unable to achieve the current targets, predictions, expectations and other anticipated outcomes expressed or implied by these forward-looking statements. In addition, certain of these disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations, including assumptions and estimates made by management. Accordingly, undue reliance should not be placed on forward-looking statements.

Forward-looking statements speak only as at today

Any forward-looking statements made or contained in this Annual Report and Accounts speak only as of the date of this Annual Report and Accounts and it should not be assumed that they have been revised or updated in the light of new information of future events. Except as required by the Prudential Regulation Authority, the Financial Conduct Authority, the London Stock Exchange or applicable law, the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this document as a result of new information or to reflect any change in the Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The reader should, however, consider any additional disclosures that the Group has made or may make in documents it has published or may publish via the Regulatory News Service of the London Stock Exchange.

No offer of securities

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